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LIABILITY INSURANCE AND TORT REFORM

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

THE ONGOING CRISIS OF THE AVAILABILITY AND AFFORDABILITY OF LIABILITY INSURANCE AND ITS EFFECTS ON THE HOUSING INDUSTRY, LOCAL GOVERNMENT, AND TRANSIT SYSTEMS

MAY 15, 1986

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LIABILITY INSURANCE AND TORT REFORM

THURSDAY, MAY 15, 1986

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met at 9:30 a.m., in room SD-538, Dirksen Senate Office Building, Senator Chic Hecht (chairman of the subcommittee) presiding.

Present: Senators Hecht, D'Amato, Gorton, Mattingly, Cranston, Dodd, Dixon, and Sasser.

OPENING STATEMENT OF SENATOR HECHT

Senator HECHT. Good morning, everyone.

The Subcommittee on Housing and Urban Affairs is holding a hearing today on the ongoing crisis of the availability and affordability of liability insurance and its effects on the housing industry, local government, and transit systems.

We are privileged to have appearing before us today our distinguished colleague from Kentucky, Senator McConnell, and representatives of professional associations, local governments, insurers, and others who have a critical interest in seeing some appropriate solutions to a problem affecting greater and greater numbers of Americans.

I am especially pleased to welcome Dr. David Allen Daileda, who is appearing today as a representative of the American Institute of Architects.

In my own State of Nevada, the cities of Las Vegas, North Las Vegas, and our State capital, Carson City, are currently without liability insurance. The counties of Douglas, Clark, and Washoe are also without insurance. Others such as Pershing and Humboldt Counties have had increases that are 10 times the previous year's rates, even with none or few losses for many years.

The public housing authority in Las Vegas has seen its rates quadruple in 3 years. These cases represent only a few of the problems being experienced nationwide. Clearly, these circumstances significantly affect the ability of State and local governments, as well as public and private entities, to conduct business and provide essential services. Currently pending before the Senate are several pieces of legislation which are designed to provide relief in the areas of obtaining and maintaining affordable insurance, as well as addressing problems facing the insurance industry and providing insurance coverage.

Our first witness, Senator McConnell, has sponsored two measures. Our distinguished colleague on this committee, Senator Dodd, working in conjunction with the chairman of the Commerce Committee, Senator Danforth, is developing a package on uniform product liability. Senator Kasten has also been actively involved in the issue. I understand that, sometime in the near future, Senator Simon will be formulating legislation addressing these problems. In addition, the President's Working Group on Tort Policy Reform recently submitted its report and recommendations for changes in tort law.

This is strong evidence that Congress and the administration are serious about developing a solution.

During the course of today's hearing, we will be exploring the difficulties experienced by public and private entities in obtaining liability coverage. We will also be exploring the difficulties of providing liability coverage, the cause for the sharp escalation of rates, even with favorable claims' histories, and the prospects for those who cannot obtain liability insurance to form user-owned mutual insurance companies.

We have asked our witnesses to relate to us some of the problems experienced by their associations, and to comment on some of the proposed solutions which are pending before Congress. Obviously, even with the many fine witnesses we have here today, this hearing will only be a partial snapshot of the problems being experienced across the Nation.

I do hope that the hearing record compiled today on the problems of the availability and affordability of liability insurance for homebuilders, appraisers, public housing, and transit providers, lenders, and local governments will assist our colleagues on the Judiciary and Commerce Committees in crafting appropriate responses.

Senator Mattingly, you were here first. Do you have an opening statement?

OPENING STATEMENT OF SENATOR MATTINGLY

Senator MATTINGLY. Thank you, Mr. Chairman.

First, I want to commend Senator McConnell on the outstanding work that he has done with reference to the area of tort reform and the problems associated with liability insurance. I think his diligence and his efforts have been very instrumental in trying to find some answers to this tremendous problem we have out there in the private sector.

I commend you, Mr. Chairman, for holding these hearings. We have all heard and read about instances where liability insurance cannot be obtained at a reasonable price, if obtained at all. We are certainly aware of the negative impact this has on individuals, on businesses, professions, State and local governments, and everybody in our country. It is a situation which must be corrected, and, I might say that it is arguable as to which factors in the past have really contributed to this problem. There is a lot of finger pointing, but I think we have to look forward now, really, to try to find the solutions, because there really is no quick fix to this situation.

I believe some changes must be made, as Senator McConnell knows, and that we're working on in reference to our tort system, while trying to protect the rights of those who are injured. And I think we must return to some certainty and to some reasonableness in our system of recovery for injury. I think we must encourage alternative methods of resolving some of those disputes, and we must assure that those recoveries go to those parties who have been injured or wronged, and not to some other party.

Let me say one last thing. I am very concerned that much of this responsibility really belongs to the State and not the Federal Government. I know we have a responsibility for Federal tort reform, but the problem is not going to go away, and I think that some of the States have addressed the problem. Some of the States have dodged the problem, and I don't think, just because a State dodges the problem, that the Federal Government ought to really be doing their work.

I know that in the area that Senator McConnell is talking about, I think you are correct in the direction that you are heading, but I think at the same time we need to make certain that the Federal Government does not get into the States' rights area or the States' responsibility and that we make certain that we stay in our bailiwick and not infringe upon the States' bailiwick, so to speak. And also, maybe the message will go out to some of the States to get busy themselves and maybe we could call some of the legislators and have them get busy on the subject.

Thank you, Mr. Chairman.

Senator HECHT. Thank you very much. Senator Cranston.

OPENING STATEMENT OF SENATOR CRANSTON

Senator CRANSTON. Thank you, Mr. Chairman. I join you and my colleagues in welcoming those present here today for this important oversight hearing on liability insurance and tort reform.

I will keep my remarks very brief, so we can quickly proceed to the panelists and the witnesses; however, I do have a few comments and observations to make on the subject of today's hearing.

With the possible exception of auto liability, it seems almost every liability coverage has skyrocketed in costs nationwide the past few years. In a growing number of instances, coverage simply isn't available. Affordability and availability of liability coverage are serious and mounting problems in California. Municipalities in my State are encountering difficulties in securing liability insurance, and when they manage to get coverage, it often is accompanied by huge rate hikes, but worst still, some towns in California just can't afford those policies.

Take, for example, Port Arena, CA. Town officials there decided to do without coverage, because it would have emptied the municipality's coffers. Another town, Blue Lake, shut down its skating rink, parks, and tennis courts, because of liability coverage problems. And some experts predict two-thirds of California's 440 towns and cities will be forced to operate without liability insurance by next July.

Public transit authorities in California are scrambling to cope with the explosive increase in insurance. In 1985, the Southern

California Rapid Transit District of Los Angeles experienced an eye-popping 2,000-percent increase in liability coverage over the previous year, 2,500 percent. There are other transit authorities in my State that are reeling under some of the rate hikes, and some who wonder whether they should risk operating without it. Others are threatened with shutdown.

Public housing authorities in California are staggering under catapulting liability costs. The San Francisco Housing Authority recently was jolted with a 1-year increase of $600,000 in general liability and property insurance. The Sacramento Housing Authority paid about $188,000 for basic coverage in 1985. This year it is forking over $453,000, but for less coverage. These type increases, coupled with cuts in operating budgets and the effects of Gramm-Rudman-Hollings, make it exceedingly difficult for public housing authorities to manage and preserve their housing stock. Municipalities and public authorities in my State are not the only sectors hit and affected by big liability hikes, of course.

Like literally everyone and everything, doctors, lawyers, engineers, dentists, hospitals, day-care centers, and businesses, large and small, are being hurt by rapidly rising rates, and so are consumers. These increases are, of course, passed on to them.

Clearly, action must be taken to address this crisis. I am glad we are examining all facets of the problem today, and I am confident that this hearing will help in the effort to get a grip on this crisis. Thank you.

Senator HECHT. Thank you, Senator. Senator Gorton.

OPENING REMARKS OF SENATOR GORTON

Senator GORTON. Thank you, Mr. Chairman.

This is, indeed, a crisis. The question of product liaibility, which is related to it, is going to be the subject of a markup on June 3, 1986, I understand, in the Commerce Committee. That we should look at this question on a broader basis simply than product liability and determine the effect on local governments and the private sector of the lack of insurance or very expensive insurance is, of course, a most appropriate function for the subcommittee.

I appreciate your chairing the hearing of the subcommittee.

Senator HECHT. Thank you very much.

Let's get right on. Senator McConnell, we are happy to have you to testify today. Would you please begin.

STATEMENT OF MITCH McCONNELL, U.S. SENATOR FROM THE STATE OF KENTUCKY

Senator MCCONNELL. Thank you, Mr. Chairman. I appreciate the opportunity to be here, and I want to commend you for holding these hearings on the effect of this problem on the housing and transit industries.

I have a statement which I would like to have inserted into the record.

Senator HECHT. It will be included in the record.

Senator MCCONNELL. I would like to take a few moments, extemporaneously, to talk about the problem of how it's developed. I was a county executive in a very large county before I came here. We had about 2,000 employees, and one of my most vivid recollections of that 7-year period was that we went from about 10 lawyers to over 50 in that 7-year period.

CRUSH OF LITIGATION

Why did that happen? It happened because of the crush of litigation, and I found, as the chief executive officer of that entity, that we spent a lot of our time funding frivolous lawsuits. I was confronted, as any chief executive officer in the private sector would be, with a continuing decision, Do I settle this case, even though I know I can win it, if I carry it all the way to conclusion at a cost of quite a lot? Do I go ahead and settle it because it is cheaper? And I found that we were constantly settling completely baseless lawsuits, because there appeared to be no disincentive to lawyers or to claimants to bring in those kinds of cases.

As time has developed over the years, we have seen what has happened here over the years with the crush of litigations in this country. Now, 1 out of 15 Americans will be involved in lawsuits this year. We have over 6,000 lawyers, 20 times per capita as many lawyers as Japan, 3 times per capita as many lawyers as the United Kingdom. Children are suing parents. Everybody is suing everybody else. We are clearly in the middle of a litigation craze. And for anybody who will assert that that has no impact on liability insurance premiums, they are simply not alive and breathing or aware of what is going on in America in 1986.

What to do about the problem? What has evolved over the last 20 years, in addition to the litigation craze, is the notion in this society that if anybody is hurt, someone must pay. When I was in law school 20 years ago, we still had such notions as fault, and we still had some feelings that occasionally we hurt ourselves, and it was our own fault, and we didn't look around for someone to compensate us for that unfortunate accident, but over the last 20 years, tort law has become very expensive.

Clearly, the notion prevailing today is that if anyone gets hurt, somebody must pay, and everybody is, of course, paying, as a result of that. It is almost as if a sweepstakes were involved, only it is a lot easier than buying a ticket on the lottery. If you buy a ticket on the lottery, there is a good chance you are going to lose. If you file a lawsuit, there is almost no chance you are going to lose. You are going to get something, no matter how baseless the claim; that's what's evolved.

Now what do you do to try to bring some sanity to that system? My good friend, Senator Mattingly, mentioned a minute ago that the States' rights issue, and it certainly is a problem in deciding what to do about this field, 95 percent of tort cases are brought in State courts.

NEED FOR A NATIONAL SOLUTION

Now do we, at the Federal level, decide to preempt in some way the State governments in this field, because it is a national problem, or do we hold back? That is one of the major policy decisions currently confronting us in the Congress. I started initially with the notion that quite possibly maybe we could deal with this in the

Federal courts only. In my original bill, S. 2046, which I will describe in a moment, I dealt only with Federal courts; however, the more I've wandered down this road and the more I've studied the problem, it seems to me that it is an issue that cries out for a national solution, and if you deal with tort cases in Federal courts only, what you do, in effect, is set up a two-tiered tort system.

Don't try to say that too rapidly. It will twist your tongue.

You get one set of results, if you have diversity of jurisdiction and wind up in Federal court; an entirely different set of results, if you don't have diversity of jurisdiction and solve the problem in the State court. And that, of course, creates a kind of disparity of results that, from a public policy point of view, is not desirable.

It is my evolving thought that this is a Federal responsibility in a limited area only, and that is the question of the damages.

I don't think there is any need for the Federal Government to step in and preempt the field of tort law in Nevada, or Georgia, or Washington, or Kentucky. There has been an evolution in tort law over the years, a body of State law that there is clearly no need to override, but when it gets down to the question of damages, what is the award going to be at the end of the process?

GUIDELINES ON LIABILITY RECOVERY

It seems to me that what we've got here is a situation in which, if we are going to bring any predictability to the system, there has to be some guidelines, some parameters around what one may recover.

So I think what we need to do is to deal with the problem on a comprehensive basis. Senator Gorton mentioned the product liability bill in Commerce, and certainly, the notion of limiting recovery in claims for product liability has been kicking around in Congress for the last 6 or 8 years. We haven't done anything yet. Maybe this committee will, but I wonder how you can defend carving out products and saying, if you happen to be hurt as a result of a product, there is a limit on your recovery. But on the other hand, if you are over here in medical malpractice or if you are in a municipality or if you are in some other area, there is no limit. The sky is the limit? I think it argues for a more comprehensive approach to tort reform, whether it is negligence or malpractice or product liability across the board. Some kind of predictability, in terms of recovery, nationwide. And to do that, the Federal Government would have to preempt the law of damages only, not the substantive tort law of State X. And that is my evolving feeling about that. Bring some predictability to the system.

Clearly, there has to be some test on recoveries for pain and suffering. I know to some people that seems heartless, but in fact it isn't.

I am not advocating any caps on recovery for economic damages, loss of earnings, medical bills, that sort of thing. But in the very subjective category of pain and suffering, which only the injured party can truly understand, there has to be some cap on that because the sweepstakes have been driven in many instances through the pain and suffering damage category.

The other category is punitive damages. In common law the notion of punitive damages was to punish the defendant for the behavior, not necessarily to reward the plaintiff.

So I think you could make an argument that the defendant is equally punished if punitive damages are paid to the court or to some other entity rather than to the plaintiff. The practical result of that of course will be to punish the defendant, but not necessarily enrich the plaintiff. That is a way to bring some sanity to the field of punitive damages.

PENALTY FOR FRIVOLOUS LAWSUITS

In addition to that, I think there needs to be some real penalty for lawyers who bring frivolous lawsuits. The bill that I have introduced, a lawyer could be fined treble the cost of the action for bringing frivolous lawsuits.

The standard also ought to apply to defense counsel who are engaged in unreasonable delaying tactics. So I think it ought to apply to both plaintiffs' and defendants' lawyers.

Finally, in the field of contingency fees, it seems to me completely unconscionable for a lawyer to be able to take up to 50 percent of the plaintiff's award. A standard contingency fee arrangement across America is a third if you settle, 40 percent if you try, and 50 percent if you appeal.

At one of the hearings we had before the Judiciary Committee, there were three lawyers before us. They happened to be plaintiffs' lawyers, and we were discussing contingency fees and talking about how that was the key to the courthouse door for the plaintiff, and I certainly agree with that and I don't advocate abolishing contingency fees.

Then we got to the subject of pain and suffering, and we were discussing, in particular, a case arising in California in which the damages awarded the plaintiff were $14.7 million.

Now, Mr. Chairman, we assumed for the sake of discussion that the lawyer got 40 percent of that. Then we took the same case and we applied the standards of my bill with a $100,000 limit on pain and suffering. And, by the way, $4 million of the $14.7 million in that case was paid for pain and suffering; $100,000 limit on pain and suffering and a sliding fee schedule for contingency fees in my bill.

And even with the $100,000 limit on pain and suffering, the injured party in that case came out much better off under my bill, with the limitation on pain and suffering, than under the current system, assuming a 40-percent contingency fee.

So the predictability to the system need not unduly penalize the truly injured party.

One final observation, and that is about the insurance companies.

In my judgment, the insurance industry is not completely without blame in this whole process. I don't think there is any question that in the early days, when interest rates were high, they went out in a fit of competition—and there is a good deal of competition in this field. It is not a monopoly type field—everybody hustled those premium dollars in in order to invest, and interest rates were up pushing 20, 21 percent.

Now, interest rates are down, and some of the risks that were written during that period are now having to be paid, and that is creating some profitability problems for insurance companies. My guess is that their profits will go up, certainly with these kinds of premiums, and even without writing premiums at all in some areas they will bring profitability back.

The problem is that the consuming public is going to go bare in many instances, whether it is day care centers or municipalities or small businesses, and ironically insurance companies who are not in the general liability field are also having a problem because they are going to go out and buy insurance for their directors and officers, which is also a difficult field to obtain.

In conclusion, what should we do?

Mr. Chairman, in my opinion, having worked on this for months and months and months, is that it is a matter of Federal concern. With all due respect to the Senator from Georgia, only 14 States have done something. Most of the State legislatures are now adjourning.

What you are going to have is some States are going to act, some aren't. Some States are going to deal in products, some States are going to deal with medical malpractice, some States are going to deal with municipalities.

You are not getting a comprehensive solution, so you are not bringing any kind of predictability to the country's problem.

In my judgment, we should enact some kind of comprehensive tort reform across the board—products, malpractice, and so on—tort reform across the board. We should do it at the Federal level or set parameters on damages, not unreasonable damages, not unreasonable parameters, not anything that penalizes the victims unnecessarily, but brings some sanity to the system that sets the guidelines for recovery in these kinds of cases.

In my judgment, Mr. Chairman, unless and until that is done, insurance is going to continue to be very high, but the rates may come down some because they are getting more profitable by not writing certain kinds of insurance at all. But the problem is going to persist.

I think the evidence is clear and overwhelming that it is a national problem that should be dealt with at the national level.

I have also introduced on behalf of the administration two bills I would make reference to in closing, S. 2440 and S. 2441, which deal with tort claims and contract claims against the Federal Government only, and we will be trying to move those bills out of Judiciary and onto the floor of the Senate. But that will protect only the Federal Government. It isn't going to do anything about the general public out there, which has an enormous problem.

TORT CLAIMS AGAINST THE FEDERAL GOVERNMENT

Senator **Mattingly**. If I might, Mr. Chairman, I am for Federal tort reform. I stated that in my statement. But I think you have to be very careful how far—tort reform is fine, but I don't think the Federal Government ought to take over the States' responsibility.

In my opinion, the State legislatures have the responsibility to handle the great part of this insurance issue, and they have evaded—some of them have—and avoided that part of it.

That is the point I made.

Senator **McConnell**. I think your point is well made.

Senator **Mattingly**. We as Republicans and conservatives ought to be careful about how far we want the Federal Government to get involved. We got involved in the energy issue and created the Department of Energy.

Senator **McConnell**. The problem is, Senator Mattingly, the administration doesn't seem to have any problem with States' rights when it comes to products liability. They are supporting a bill on product liability.

What is the problem with medical malpractice?

Senator **Mattingly**. I have been in the Senate 5½ years, and product liability has been out there for 5½ years. I haven't seen it enacted into law yet irrespective of what the administration wants.

Senator **McConnell**. My own view is that this is a national problem. I don't think the Federal Government ought to go running it.

My voting record is probably about as conservative as yours, but having studied this problem, in my judgment the solution is not necessarily to tell Georgia what its tort law ought to be but we might ought to tell Georgia, Nevada, and Kentucky that when you get to the end of that case and you get down to the question of recovery, which is going to be passed on to the public in terms of insurance rates, that there ought to be some parameters because otherwise you are going to have cases like the current one on appeal from Alabama, which I will describe for you briefly.

Senator **Mattingly**. On a humorous note, somebody made the comment the other day you were bringing up about how many attorneys there were in the United States. If we want to resolve the trade issue between Japan and the United States, send them one lawyer. [Laughter.]

Senator **McConnell**. I shouldn't talk that way since I am a lawyer.

This Alabama case involved $1,500. The plaintiff got approximately $1,500. He thought he ought to get $3,000. He sued the health insurance provider, and the jury gave him $1,500,000 in punitive damages over a $1,500 claim.

Now, in my judgment, Senator Mattingly, that kind of foolishness cries out for some kind of national parameters.

I think we can do that. The approach that I recommend doesn't set up a new Federal agency. It doesn't set up any new Federal court jurisdiction.

It just would say, as we have said frequently over the years, that there are certain things, points beyond which you cannot go even in your State court with your State law, not setting up a new Federal bureaucracy, but we are setting up some parameters under this approach to be applied throughout the system.

And I think the administration is on poor footing to argue against it, since they completely waive States' rights when it comes to products.

Senator **Mattingly**. It is in the eyes of the beholder always, right?

[The complete prepared statement follows:]

Those of us who are interested in effecting some real reform need to coalesce around one particular approach to the insurance and liability crisis. In the past, the forces for change have been divided, which only benefits those who oppose change. With the Administration now involved, and with the recent introduction in the Commerce Committee of legislation similar to my own, we may finally be able to overcome the inertia that has been holding us back.

Mr. Chairman, as a cosponsor of my legislation, you know full well the nature of the problem. I commend your effort to investigate the liability crisis, and in particular, its effect on the housing and transit industries. I appreciate the opportunity to appear before you today, and I would urge each of the other members of the Subcommittee to join us in solving the problem once and for all. Thank you, Mr. Chairman.

Senator HECHT. Thank you very much, Senator.

I have to say that is a very, very courageous approach. You are going to be a hero to the business people, the medical profession, the public at large. I don't know how you are going to react to your own legal profession. [Laughter.]

But I am sure in the next few weeks you are going to hear a little bit about that.

But your extemporaneous speech was probably the finest I have heard on the issue. You have addressed all of the problems.

I am very proud to be a cosponsor of your bill, and together I hope we can work out this tremendous calamity, which is just exactly what it is, all around America, in my State, your State, Mack, in your State, everywhere.

We are going to have to find some solutions. That is the reason we are having these hearings, and you will have your hearings. It is going to be a pleasure to work with you.

Thank you for appearing today.

Senator MCCONNELL. I appreciate everything you have to say. This is a most important hearing, and I am very glad that you are providing the leadership through this committee to talk about the housing and transit industry.

Senator HECHT. We wanted to bring this area to you so that when you work on your bill we will have your input at that particular time because it is so critical to this area.

Senator Dixon.

STATEMENT OF SENATOR ALAN DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Housing Subcommittee conducts oversight hearings on liability insurance and tort reform issues.

I will not take the time of the committee to recite my own favorite list of liability horror stories. While the stories are entertaining to tell, the subject is not funny. Too many individuals, businesses, and State and local governments have faced terrible rate increases, or even worse, can't get insurance at all. The result is additional expense that all consumers ultimately have to pay. The result is also increasingly, that some products and some activities are less available, or in some cases, not available at all.

I hope we will not spend our time today trying to assess blame—that won't solve the problem. Rather, I hope we can use this opportunity to come to a better understanding of the problem and its causes, so that we can craft appropriate solutions.

This is an area that has traditionally been the responsibility of the States. Both insurance regulation and the tort system have been almost totally State matters. The Federal Government, therefore, must act in a way that respects that fact, and not attempt to run roughshod over legitimate State interests. It is also vitally important not to lose sight of the interests and rights of consumers and employees who are injured.

Having said that, however, I also have to say that I believe the system does need change. In many cases, as much as two-thirds or more of the cost of a liability case to an insurance company is not the money that goes to a plaintiff—its transaction costs, the money paid to plaintiff's lawyers, defendants lawyers, and for other numerous administrative purposes. We ought to be able to find a more efficient and reasonable way to ensure that those entitled to damages receive that money.

I support, for example, Federal product liability legislation. In my view, it would make sense to structure such legislation around the restatement of torts, which reflects the consensus of the States in the tort area. The proponents of Federal product liability legislation, however, have made a compelling case on the need for action by Congress.

I am also giving legislation that addresses broader liability issues my careful consideration. I think that suggestions to reform legal procedures in a way that will encourage greater use of alternative dispute resolution mechanisms and increase the amount that goes to injured parties while reducing overall costs has potential.

We have a distinguished group of witnesses before the committee this morning. I am sure I will learn a great deal from their testimony, and their recommendations.

Senator HECHT. Thank you, Senator.

Let's bring up the next panel. Leonard Miller, David Daileda, John Rousselot, and Richard Gaskins.

Gentlemen, your entire statements will be for the record, and I will ask you if you could perhaps condense them down to 5 minutes for the oral statements.

Mr. Gaskins, would you like to start, please?

STATEMENT OF RICHARD GASKINS, EXECUTIVE VICE PRESIDENT, AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS

Mr. Gaskins. Mr. Chairman, other members of the committee, I am Richard Gaskins. I am here today to testify on behalf of the American Institute of Real Estate Appraisers of the National Association of Realtors.

I am the executive vice president and chief administrative officer.

Peter Bowes, MAI, the current president, has asked me to represent the Appraisal Institute at this hearing because I am the one who receives the calls and letters from our membership regarding their inability to obtain errors and omissions insurance, and I am the one who has been seeking a solution to this problem for our constituents for the past several years.

For those of you who may not be familiar with the Appraisal Institute, I will give you just a brief profile.

We are the appraisal association representing the National Association of Realtors, which, as you know, is the largest trade association in the United States.

BACKGROUND OF THE APPRAISAL INSTITUTE

The Appraisal Institute is also the oldest appraisal association, founded 54 years ago during the Depression, when tremendous losses and abuse of real estate investment practices were experienced and, quite frankly, some abuses involving appraisal practices.

We are the foremost publisher of real estate appraisal publications and books. We are the leader in the field of real estate education. We provide grants for research and offer courses and seminars for the general public as well as our membership, and we grant a large number of annual college scholarships to various American universities.

We have about 6,200 active candidates and 7,200—I am sorry—6,200 active members and 7,200 active candidates, all of which are under our standards of practice and are under our code of ethics.

Until about 10 years ago, a very small percentage—we estimate less than 10 percent—of our membership had any kind of errors and omissions insurance. Now, particularly in the last 5 years, we find that the trend has reversed due to primarily two factors.

One is that financial institutions now require an appraiser to carry errors and omissions insurance in order to qualify for what they consider to be an approved list.

This, plus the fear of defense costs in this increasingly litigious society has made a dramatic impact on our constituency.

CONCERN FOR RISING RATES AND COVERAGE

I would like you to know that I am not here to express the concern over the rising insurance rates, which quite frankly in the last

STATEMENT OF SENATOR MITCH McCONNELL
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
MAY 15, 1986

Mr. Chairman, I want to commend you for your leadership in conducting an oversight hearing to investigate the current liability insurance crisis as it affects the housing and transit industries. I thank you for this opportunity to testify before you today.

There is essentially no argument today that we face anything other than a problem of crisis proportions in the liability insurance field. It is a crisis that hits everyone, from the homeowner, to the working mother, to the owner of a small business, and to the largest corporation.

In my view, it is a crisis that stems in large part from the unconstrained expansion of tort liability in the United States over the past 25 years. Hardly a day goes by that we do not hear or read of the dramatic increase in the number of lawsuits filed, of another huge punitive award, or of another small business, child care center, or municipal corporation that has had its insurance cancelled out from under it. Those businesses and corporations that are able to retain their insurance are often met with increases in premium costs of 100 percent, 200 percent or more.

Why are insurance rates increasing so dramatically? Why are the courthouses so crowded, despite the addition of over 100 federal judges in the last 8 years? Because, in large part, everyone is suing everyone, and most are getting big money.

Something is clearly wrong when the number of product liability cases filed in federal court increases 758% in a ten year period, as it did between 1974 and 1984. And something is clearly wrong when the number of malpractice cases per 100 physicians doubles in the same time span. Reacting to facts like these, no less a jurist than Chief Justice Warren Burger has commented that "there has been a litigation explosion during this generation", with "remedies for personal wrongs that once were considered the responsibility of institutions other than the courts . . . now boldly asserted as legal entitlements."

Some, including the National Center for State Courts, have suggested recently that there has been no real increase in litigation. But while there may be some question about the number of cases filed in state courts, no one can seriously dispute that the number of serious cases is dramatically higher that ten years ago. Without a doubt, our present civil justice system promotes litigation, almost for litigation's sake. What is most disturbing about this state of affairs is that so little good comes from so much litigation. Indeed, this crisis will most likely reserve its harshest consequences for American consumers, as well as for industries like housing and transit, which are of vital importance to the consumer.

Mr. Chairman, trends like those we have seen in the field of tort law simply cannot be permitted to go unattended, and I cite all this to make the point that the tort law has gone unchecked and uncontrolled for too long. If you are in the risk-spreading business, and the insurance companies are in just that, and you look at what is happening in America today, it is hard to know how to spread your risks. With the court system today, and the tort law doctrines that it applies, insurance companies simply cannot know how to spread the risks they set out to insure.

Consequently, I think the only thing that will really bring some order back to the liability insurance system is order in the tort system. As you know, I have repeatedly brought this crisis to the attention of the Senate, and have chaired two hearings for the Judiciary Committee this session on just this issue.

In addition, I have introduced three bills in this session that will, in my judgment, take us a long way back to order in the tort system, and with it, to reasonableness in the liability insurance market. On February 5, I introduced the Litigation Abuse Reform Act, S. 2046. I believe it helps chart a course back to a sensible balance between free and unfettered resort to the courts and recognition of the need for a more pragmatic, responsible approach for dealing with civil disputes.

S. 2046 seeks to impose rational restrictions on the award of damages in Federal courts, and to impart a significant degree of predictability to the liability a defendant faces. It does this by putting a cap of $100,000 on the award of noneconomic damages, or "pain and suffering" awards. These are awards that are inherently unpredictable, and limited only by the whim of the jury. Importantly, this limitation will not - I repeat, will not - deprive any injured party of the first nickel in actual, economic damages, such as past or future medical expenses, or loss of earnings.

In addition, S. 2046 would require periodic payments of awards of damages greater than $100,000, on a schedule approved by the court. It would eliminate the collateral source rule, requiring that damage awards be reduced by the amount of any other payment, such as insurance or worker's compensation, that a plaintiff has received as a result of his or her injury. These benefits, on top of the award to actual damages, are a windfall to the plaintiff. Though it may once have been important to exclude such benefits from the computation, in order to deter negligent conduct, that time has long since passed.

The bill would also clarify the standard to be used for the award of punitive damages, and provide that such awards are to be paid to the court. Punitive damages were never intended to compensate the plaintiff, and their punitive effect will be just as great if paid to the court or some other appropriate body, while removing the incentive for lawyers to pursue large punitive awards.

There are two other major provisions of the bill. One will limit the amount of contingency fees that an attorney may obtain in a case, based upon the amount of the recovery. There is no point in watching an ever growing portion of the awards in tort cases go to lawyers, many of whom have become fabulously wealthy, part of what the ABA trumpeted recently on the cover of its Journal as part of the new elite plaintiffs' bar. The other provision would clarify the standards for holding lawyers who file pleadings without a good faith belief in the substance of them liable for costs, including attorney fees. It would also create a new sanction against lawyers who initiate any civil action without a reasonable belief that there is good ground for recovery of the relief requested, or merely to force a monetary settlement. The bill would hold such attorneys responsible for treble costs, including the attorney fees necessary to resist the action.

On Tuesday of this week I introduced S.2440, the Federal Tort Claims Reform Act, and S.2441, the Government Contractors Liability Reform Act. These bill, which are very similar to my earlier legislation, were drafted by the Reagan Administration following the recommendations of the Administration's Tort Policy Working Group. In addition to many of the provisions found in S.2046, both of these bills propose a return to a fault-based standard of imposing liability, as well as a general elimination of the doctrine of joint and several liability. I believe each of these provisions is an important reform that goes to the heart of the issues before this Subcommittee today.

At the same time, I recognize that the insurance industry is not blameless in connection with the liability crisis. Indeed, a number of suggestions have been made that the industry is in fact chiefly responsible for the crisis. Some have suggested that the trends in jury verdicts, and in the amount of litigation is not out of line with expected increases due to inflation and population gains - in short, that there is no crisis. I agree that the insurance industry itself should be studied, and I have been insisting that representatives of the industry provide me and the Judiciary Committee with concrete documentation for the problems they suggest are making insurance unaffordable or unavailable.

But the fact is that the number of civil cases filed in federal court has increased over 100% in just 10 years, far more than the population. In testimony on S.2046 before the Judiciary Committee, the Rand Corporation's Institute for Civil Justice reported that in the medical malpractice field, over the past ten years "claim severity increased at almost twice the rate of increase in the Consumer Price Index." These increases are far greater than the general level of price increases. Something is responsible for this pattern, and we need to get to the bottom of it.

I firmly believe that S. 2046 and the bills I introduced on behalf of the Administration represent important steps toward this goal. Testimony by the Institute for Civil Justice confirms that tort reforms of the kind I have proposed "had important downward effects on settlements, verdicts, and the number of cases pressed to judgment, while tending to increase the number of claims that were dropped without payment".

few years have risen something like 600 percent, even against insureds who have had no claims.

I am here though to speak on behalf of the ability of appraisers to obtain insurance at all. Right now there are, I would say, three basic areas that we need to look into.

First, with regard to coverage, our concern of the inconsistent and expanding exclusions from coverage that are being incorporated into various D&O policies. I have submitted a prepared statement which will outline these.

Senator HECHT. Thank you. It will be in the record.

Mr. GASKINS. There is an exclusion in each of the policies I have referred to regarding syndication which is particularly significant to our members because public syndicators monitored by the SEC marketed nearly $7 billion in real estate investment in 1985. Accurate data is really not available because of the amount of private syndication, but it is estimated that the total offerings may be in excess of $24 billion of real estate, which was first appraised and then syndicated in 1985.

In almost every case the Appraisal Institute members appraised that property. This means at a time when the general public really needs good quality real estate appraisers we find ourselves without any kind of errors and omissions insurance in many instances, or at least not viable programs, so that we can continue to practice.

There is what I call general availability problems. Insurance companies are struggling to try to ascertain the degree of need and liability of real estate appraisers. There is a definite need for uniform policies because of what I call irrational underwriting practices.

To just cite a few examples, we have begun receiving programs and policies that say that they will not insure appraisers who practice out of their own State, which is ludicrous for a commercial real estate appraiser. That would require that as much as 40 percent of all the work to be performed in residential appraisal, which again is not consistent with what is done as a practice of real estate appraisers.

I mentioned the fact of syndication and the exclusions that they have entered into there, which is very critical in the overall marketplace. We have regulatory problems that I think the States should handle, such as when time comes for renewal of programs. We frequently find, without notice, that our policies have not been renewed.

Senator HECHT. Your 5 minutes are up. Would you please recap in the next minute.

Mr. GASKINS. We believe that the ultimate solution lies principally in reform of the judicial system.

We would like to thank you very much and commend you for attacking this problem and addressing it, because we feel it is the No. 1 single biggest problem facing our constituents today.

[The complete prepared statement follows:]

TESTIMONY OF RICHARD B. GASKINS
EXECUTIVE VICE PRESIDENT OF
THE AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS

BEFORE THE SENATE COMMITTEE ON BANKING
ON
MAY 15, 1986

Mr. Chairman, and other members of the Committee, I am Richard B. Gaskins and I am here today to testify on behalf of the American Institute of Real Estate Appraisers of the National Association of Realtors (which is also known as the "Appraisal Institute"). I am the Executive Vice President of the Appraisal Institute. Peter D. Bowes, MAI, the current President, asked me to represent the Appraisal Institute at this hearing because I am the one who receives the calls and letters from our members concerning their inability to obtain appropriate errors and omissions insurance, and I am the one who has been seeking a solution to this problem for several years.

The Appraisal Institute commends this Committee for inquiring into the desperate problem that has been created for professionals by the crisis in the errors and omissions insurance industry. We believe that this crisis has been particularly severe for appraisers. We also believe that to a large extent, the crisis for the appraisal profession is the result of perceptions and fears rather than fact.

1. Profile of the Appraisal Institute

For those of you who may not be familiar with the Appraisal Institute, I will give you a very brief profile. The Appraisal Institute is the appraisal arm of the National Association of Realtors, which as you know is the largest trade association in the United States. The Appraisal Institute is also the oldest and most respected appraisal organization in the United States. The need for a professional association of real estate appraisers became apparent during the depression, when investors and lenders suffered tremendous losses as the result of abusive real estate investment and lending practices during the boom of the 1920s. Some of these abuses involved faulty appraisal practices. The founders of the Appraisal Institute envisioned that the Institute would serve a public need by awarding a professional designation to those appraisers who met rigorous standards of education, experience and ethics, which

in turn would provide the real estate industry and the public with the opportunity to select and rely upon such qualified individuals.

The vision of those who founded the Institute has come true. Today the Appraisal Institute awards its professional designations to real estate appraisers who have completed extensive educational and experience requirements and have agreed to adhere to the Institute's ethical rules and appraisal standards. Because of this, lenders and investors commonly require that appraisals of real property be prepared and signed by individuals who hold an Appraisal Institute designation.

The Appraisal Institute is also the leader in the field of real estate appraisal education and the foremost publisher of real estate appraisal literature. It provides grants for research and offers courses, seminars, books, periodicals, and informational brochures to members, candidates, and the general public.

The Appraisal Institute offers two professional designations: MAI (Member, Appraisal Institute) and RM (Residential Member). MAIs include specialists in the appraisal of commercial, industrial, residential and other types of properties. RMs are specialists in the valuation of single-family dwellings and two to four-unit residential properties.

There are currently 4,966 MAIs and 1,236 RMs throughout the United States and Canada. There are also 3,921 candidates for the MAI designation and 2,662 candidates for the RM designation, which brings a total of approximately 13,000 individuals under the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice.

2. Qualifications for Membership, Standards, and Certification

The qualifications for an Appraisal Institute designation are similar in many respects to the qualifications required to obtain a designation in the accounting profession, i.e., a combination of academic testing and "real world" experience that has been checked and rated for quality. To achieve the

MAI designation, an MAI Candidate must first pass a series of specific examinations, obtain credit for various demonstration appraisal reports and obtain credit for at least five years of appraisal experience, of which three years must be specialized. Upon completion of these requirements, the candidate must then pass a Comprehensive Examination. In addition, prior to being awarded the MAI designation, an MAI Candidate must possess a college degree or its equivalent and become a member of the National Association of Realtors.

To achieve the RM designation, an RM Candidate must pass a Residential Appraisal examination, obtain credit for various demonstration appraisal reports and obtain credit for not less than three years of real estate experience, including two years of residential appraisal experience. In addition, prior to being awarded the RM designation, an RM Candidate must have graduated from an accredited four-year high school and become a member of the National Association of Realtors.

Throughout the period of candidacy, candidates must observe the requirements of the Appraisal Institute's Code of Professional Ethics and Standards of Professional Practice, as interpreted in the Explanatory Comments and Guide Notes that accompany both the Code and the Standards.

Once designated, both MAIs and RMs participate in a voluntary program of continuing education in order to qualify for recertification every three years.

3. The Errors and Omissions Insurance Problems Faced by the Appraisal Profession

Ten years ago, a very small percentage of the members of the Appraisal Institute carried errors and omissions coverage. This situation changed dramatically over the last ten years when malpractice suits against doctors, lawyers, accountants and architects resulted in large verdicts against various defendants. Another factor leading appraisers to purchase errors and omissions insurance is the fact that many financial institutions now require an appraiser to carry errors and omissions insurance in order to qualify for the "approved list" of appraisers that the financial institution will accept for loan purposes. In recent months, however, the situation has changed again and a smaller percentage of our members are insured. Members of the appraisal profession have been pitched into the midst of an errors and omissions insurance crisis. For convenience, I will discuss these problems under four headings: cost, coverage, geographic availability, and general availability.

a. Cost

The first area of concern is a startling increase in the cost of errors and omissions insurance that bears no relationship to the actual loss experience of the insurance carrier. For some members, the cost of errors and omissions insurance has increased more than 600% in two years even though the insured party did not have any claims filed against him. If this increase in the cost of errors and omissions insurance had any relationship to the loss experience of the insurance carrier, the Appraisal Institute would have no concern. However, we believe that these startling increases in cost have no relationship whatsoever to the actual loss experience of the insurance carrier. In other words, the appraisal profession is paying the cost of problems incurred in other areas.

b. Coverage

The second area of concern is the inconsistent and unexplainable exclusions from coverage that have been incorporated into various errors and omissions insurance policies. For example, in July, 1985, the same insurance administrators renewed two errors and omissions insurance policies, one for a member of the Appraisal Institute in California and the other for a member of the Appraisal Institute in Lansing, Michigan. The renewal policy issued to the member in California gave coverage worldwide (except in Communist countries), but excepted from coverage all appraisals made of properties that were to be syndicated or were involved in SEC filings. The renewal policy issued to the member in Michigan provided coverage only for appraisal work done in the State of Michigan and excluded coverage for appraisals done outside that state. Moreover, the exclusion relating to syndication differed from the syndication exclusion in the policy issued in California and excluded coverage for "appraisals done for a general limited partnership, joint venture, unincorporated association, or similar organization formed for the purpose of, and engaged in, investment or gain from an interest in real property, including but not limited to a sale, exchange, trade or development of such real property." No mention was made of appraisals done for an SEC filing.

The exclusion in each of the policies referred to above relating to syndication is particularly significant to members of the Appraisal Institute. Public syndicators monitored by the SEC marketed nearly $7 billion in real estate investments in 1985. Although accurate data is not available as to the dollar amount of private syndications consummated in 1985, it is estimated that the total offerings of that type may be approximately two and one-half times the volume of public offerings. If this estimate is accurate, more than $24 billion of real estate was first appraised and then syndicated in 1985. In almost every case, the appraisal of this real estate was done by a member of the Appraisal Institute. This means that at a time when the general public needs the best possible appraisers to estimate the value of real estate which is being marketed to the public in the form of a syndication, the appraisers involved cannot obtain errors and omissions coverage to protect themselves if a lawsuit is filed by an investor in the project.

It is important to note in this connection that errors and omissions insurance protection is required even though the appraiser involved did an excellent job. The securities laws of the United States and the "blue sky" laws of the various states provide special remedies to investors in securities, and when suits are filed under these laws, the plaintiff will name as a defendant every individual and company that had anything whatsoever to do with the security involved. This means that even though the appraiser did an excellent job, he may very well be sued because of something that someone else did.

Further, although the fee paid to the appraiser will be a very small percentage of the total cost of the issuance of the security, and although the appraiser will have no participation in the profits of the sale, if a suit is filed by a disgruntled investor, the appraiser will be required to retain his own attorney and pay the fees incurred in what often is complicated litigation. Ultimate vindication by the court is of little satisfaction to the appraiser who has spent his life savings in proving that he was not guilty of an error or omission.

c. Geographic Availability

A third area of concern is the fact that errors and omissions insurance is completely unavailable in some states. We have been advised that one of the carriers issuing errors and omissions insurance to appraisers is qualified to do business in 26 states and that another is qualified to do business in 23 states; but there are a number of states that simply do not have a carrier qualified to issue errors and omissions insurance to a professional real estate appraiser. This is an intolerable situation for the professional real estate appraiser located in these states.

d. General Availability

The fourth and final area of concern can best be described as "irrational underwriting practices" that limit the general availability of errors and omissions insurance. Two examples may suffice to illustrate this point. A past president of the Appraisal Institute was recently denied coverage by one of the major carriers of errors and omissions insurance on the ground that he was primarily involved in appraising commercial properties and counseling major banks and investors. The insurer indicated that if he would devote 40% of his time to the appraisal of residential properties, he would then qualify for errors and omissions insurance coverage. In order words, at a time when the very best appraisers in the country are needed to appraise the billions of dollars worth of commercial real estate that are being marketed to the public, the errors and omissions insurance carriers are telling such appraisers to "go back and appraise single family residences so that you can qualify for errors and omissions insurance."

Another past president of the Appraisal Institute currently has several applications for errors and omissions insurance pending, but no coverage. One insurance carrier has indicated that it would not issue a policy to him because he does "too much commercial work" and does not have a high enough percentage of assignments in written contract form. Another carrier advised him that he did too much appraisal work out of state.

It is important to note in connection with both of the examples cited above that neither individual has ever had a claim filed against him in the entire course of his appraisal career. The sole basis of the denial of insurance coverage to these individuals is the fact that these individuals are doing appraisals of expensive commercial real estate. They are chosen for this work because they are the best in the business; therefore, they do not qualify for insurance.

4. Perception vs. Fact

In its transmittal letter to a member of the Appraisal Institute last year, an insurer explained the increase in its rates and the reduction of its coverage in the following language:

> "In the past two years real estate appraisers have been included as "targets" in real estate litigaton. Articles in the Wall Street Journal, Los Angeles Times, Washington Post all mention real estate appraisers involved in various financial institutions' land and real estate losses. Today, a Professional Liability policy should be considered a business necessity.
>
> "The premium you have been quoted reflects the results of a survey of the many real estate appraisers' claims we have received in the past two years.
>
> - For lawsuits involving commercial properties, the average amount the appraiser is being sued for is $510,000+, while residential appraisal suits have an average amount of $167,000+.

> - Lawsuits are expensive. The pre-trial legal defense costs are much higher for appraisers than for other occupational classes in the insurance industry."

When the transmittal letter referred to above was passed on to the Appraisal Institute, we contacted the insurance company and sought to obtain information concerning the claims referred to in the letter. The insurance company involved not only refused to disclose the number of claims, but also refused to disclose any details of the case or cases involved, so that it is impossible for us to determine whether the claim was a securities case in which the real estate appraiser was included as an afterthought or whether the claim was primarily directed to the negligence of the real estate appraiser. The inability of the Appraisal Institute to procure reliable, factual information relating to claims made and claims paid is a major stumbling block in its efforts to procure errors and omissions insurance for the appraisal profession on a rational basis.

There are, however, some facts that we do know. In October of 1975, the Appraisal Journal contained an article entitled "Appraisers' Malpractice: A Cloud No Bigger Than A Man's Hand?" In the course of this article, the author, Professor Gideon Kanner, stated that, "With all the current publicity about the medical malpractice 'crisis,' it may be an opportune time to take a quick look at the concept of professional malpractice and its potential applicability to the appraisal profession." After discussing malpractice in general, Professor Kanner then asked the question, "How does this apply to appraisers?" His answer was that the answer was not entirely clear, because "there appears to be no decisional law in this country dealing with appraisers' malpractice." The balance of the article is devoted to decisional law from England and Canada which he felt would provide some insight into the situation.

Professor Kanner, who was a professor of law at Loyola University School of Law in Los Angeles, followed up this article with a second article that was published in the Appraisal Journal in January, 1977. This article opened with the comment that:

> Some time ago we took a brief look at the problem of professional negligence of appraisers, i.e., malpractice, and found ourselves unable to find any important American cases, even though the subject had been litigated in England and Canada. We still have no American cases, but there have been further developments in England.

In October, 1981, the Appraisal Journal published an article entitled "Law and the Appraiser" by Stanley J. Fineman, who is a member of the law firm of Wilkes, Artis, Hedrick & Land, Chtd., which specializes in real estate in the Washington, D.C. area. In this article Mr. Fineman discusses one case in which an appraiser was held liable for a conflict of interest and four cases in which an appraiser was held liable for negligence. Three of these four negligence cases involved a personal residence and one involved a commercial property. In each case, the liability of the appraiser ran to his or its client.

The liability of an appraiser for negligence was broadened by a Decision of the Wisconsin Court of Appeals in 1985. This case, bearing the title Costa v. Neimon, held that a real estate appraiser that was hired and paid by a lender should have foreseen that a prospective buyer of property being appraised was "within the ambit" of harm which could result from a carelessly done appraisal, and therefore the purchasers of the home could recover from a real estate appraiser for a negligent appraisal. The Court further held that the evidence supported a finding that the purchasers believed in and relied on an appraiser's negligent misrepresentation of fair market value, but reversed a judgment in favor of the plaintiffs in the amount of $8,500 because of another finding that the award was excessive and the evidence did not support an award in this amount.

The information set forth above is substantially all we have to go on in attempting to understand and solve the errors and omissions insurance crisis for the appraisal profession. At the moment, the crisis appears to be based more on perception and fear than on fact. This conclusion is supported by the fact that earlier this year the Appraisal Institute was negotiating with a major insurance carrier to make available errors and omissions coverage to members of the Appraisal Institute. In this connection, the Appraisal Institute provided the carrier with extensive, detailed information concerning the appraisal industry and the qualifications of its members. Everything was going well until The New York Times and the Wall Street Journal published several articles dealing with the failure of various thrift institutions and some large losses in the real estate portfolios of large banking institutions. These articles implied that faulty appraisals might be responsible for such failures and losses, and, as a result of these newspaper articles, the insurance carrier panicked and no further progress has been made.

We believe that the crisis in procuring appropriate errors and omissions insurance that is now being experienced by the appraisal profession is not the result of an unfavorable loss experience relating to appraisers, but rather is the result of an unfavorable loss experience relating to other professionals, such as doctors, lawyers and accountants. We also believe that it will be difficult for members of the Appraisal Institute to procure appropriate errors and omissions insurance in the marketplace until progress has been made in solving the errors and omissions insurance problem currently facing all professionals.

5. Possible Solutions: Legislative, Regulatory and Private Sector Initiatives

a. Desirable Legislation

(1) Reform of current concepts of damages

We believe that various reforms relating to current concepts of damages would be very helpful in curing the errors and omissions insurance crisis. These reforms would include the abolition of the "joint and several liability" principle so that an award of damages would be based upon a defendant's share of negligence, rather then on a defendant's ability to pay. Another helpful reform would be the elimination of punitive damages in connection with civil liability for errors and omissions.

(2) Reforms Relating to Speculative Lawsuits

We believe that the crisis in errors and omissions insurance would be eased by the implementation of a program that would (i) fine plaintiffs whose cases are judged to be frivolous, and (ii) require such plaintiffs to pay the legal fees of the defendants as well as the court costs. Another useful reform would be to limit the contingency payments made to lawyers who file errors and omissions cases. The Appraisal Institute recognizes that these reforms would have to be carefully structured and implemented, and that they would not be a panacea to all of the current problems. However, we also believe that unless appropriate legislative steps are taken to curb the abuses of the current judicial system, there can be no long-range solution to the errors and omissions insurance problem.

(3) Reform Relating to Privity

Appropriate legislative action should be taken to ensure that further departures from the concept of privity will not occur. The decision of the Court of Appeals of Wisconsin in the Costa v. Neimon case is an unfortunate trend and appropriate legislative action should be taken to ensure that professionals are held liable to those who pay their fees and are entitled to rely upon their work product. The expansion of this liability to anyone having subsequent contact with the property will only make more difficult a solution to the current crisis in obtaining appropriate errors and omissions insurance.

b. Desirable Regulatory Action

Information in the files of the Appraisal Institute indicates that members are frequently given little or no advance notice of the intent of an insurer to cancel or refuse to renew a policy. In addition, members are not given a clear notice of changes in the policy that have a significant impact upon the coverage provided. We believe that appropriate steps must be taken to work with the regulatory agencies at the state level to ensure that insurance carriers provide at least 90 days' prior written notice of any intent to cancel or to refuse to renew an errors and omissions insurance policy. In addition, appropriate regulations should be issued to require clear and precise notice to policy holders of all changes in a policy that would have a significant impact on the coverage provided.

At the national level, we think that steps should be taken to increase the capacity of the insurance market to handle errors and omissions insurance needs by encouraging the formation of properly regulated "captive" insurance companies. In this connection, appropriate steps should be taken by the Internal Revenue Service and other governmental agencies to clarify regulations dealing with insurance companies so that such "captive" companies will be able to function.

c. Steps To Be Taken by the Private Sector

The Appraisal Institute is currently taking a number of steps to assist its members in dealing with the crisis in procuring appropriate errors and omissions insurance. The first step is to encourage members of the Appraisal Institute to use written contracts that spell out the terms and conditions of their employment and place various restrictions upon the use of their appraisal report. A second step is to increase the Appraisal Institute's efforts to monitor the availability of errors and omissions insurance from various insurance carriers, as well as evaluate of the coverage provided by each form of policy. This information will be gathered and made available to members of the Appraisal Institute on a regular basis.

Another step being taken by the Appraisal Institute is the encouragement of appropriate regulation of the appraisal profession. The Governing Council of the Appraisal Institute supports a program for the regulation of the appraisal industry that is similar in all respects to the current system regulating the accounting profession. By upgrading the standards of the profession and then enforcing these standards through a program adopted by each state, the quality of the work product of the appraisal profession will be improved and the desirability of insuring members of the appraisal profession will be enhanced.

Finally, the Appraisal Institute is studying a program to set up a "captive" insurance company for the members of the appraisal profession. This "captive" company will be supported by at least one other major appraisal organization. The Appraisal Institute would prefer that appropriate errors and omissions insurance coverage would be available in the marketplace. At the present time, however, there is no assurance that appropriate coverage will be available. Therefore, the Appraisal Institute intends to study the feasibility of a "captive" insurance company to serve the appraisal profession until such time as the desired legislative and regulatory reforms have cured the crisis in the errors and omissions industry and thereby made appropriate coverage available in the marketplace.

Senator HECHT. Thank you very much.

The distinguished former Congressman John Rousselot.

STATEMENT OF JOHN H. ROUSSELOT, FORMER REPRESENTATIVE IN CONGRESS OF THE UNITED STATES FROM THE 26TH DISTRICT OF THE STATE OF CALIFORNIA, PRESIDENT, NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

Mr. ROUSSELOT. Thank you, Mr. Chairman. I appreciate the chance to appear as president of the National Council of Savings Institutions. I would like to give you our perspective on the crisis in the directors and officers liability insurance market as it affects financial institutions today.

PROFILE OF THE NATIONAL COUNCIL

First, let me just quickly state the background of the National Council. The National Council represents approximately 600 thrift institutions. Our members' average asset size is about $800 million; their average capital ratio is about 6 percent. Many of our member institutions remain in the mutual form, although we have seen a significant number of conversions to the stock form over the last several years, with very strong activity in the first quarter of 1986.

The National Council is the product of the merger of the National Association of Mutual Savings Banks, which represented approximately 400 savings banks, and the National Savings and Loan

League, which represented slightly over 200 savings and loan associations throughout the country.

In 1972, our predecessor organization, the National Association of Mutual Savings Banks created an offshore reinsurance company called Drayton, Ltd. in Bermuda. It was established in response to an extremely tight insurance market, very similar to today's market. At that time, however, the scarcity was in the mortgage impairment insurance--that is, insurance which protects lenders in the event of an earthquake or flood, and as you know, we have those occasionally in California.

Since its inception in 1972, the company has grown steadily and increased its product lines to include reinsurance of directors or trustees and officers, for what is known as D&O insurance, and also blanket bond coverage. So-called front companies, licensed to do business in the United States, have been the primary carriers on these programs with insurance provided through Drayton. Approximately one-third of our members, primarily mutual savings banks, have been able to obtain D&O insurance and blanket bond insurance through this facility. As you know, it is essential for financial institutions to be able to obtain D&O insurance if they are to attract and retain competent management and directors.

In today's litigious atmosphere, those qualified to fill such positions will not serve unless they are given appropriate insurance coverage against unreasonable risk of personal liability and are protected against the very substantial costs of defending or settling actions which are not well-founded.

D&O COVERAGE PROBLEMS

Now let me tell you quickly what has happened to our members over the last year, which I know is one of the areas you wish to cover. Up until about 1½ years ago, our members were offered 3-year D&O policies with very low deductibles and quite modest premiums. In mid-1985, all 3-year policies were canceled and rewritten as one-year policies and premiums went up anywhere from 400 to 1,500 percent. Deductibles were raised significantly in the larger institutions and the coverage was drastically reduced, to the point that one member proclaimed that he would only be protected under the policy for suits filed by depositors alleging discriminatory practices.

Why did this happen? Well, there's a lot of factors, and I won't go into all of them, but first, the insurance industry is a very cyclical industry. In the late 1970's and 1980's, the name of the game in insurance was investment income. Of course, with interest rates near 20 percent, it seemed reasonable not to worry about underwriting for risk and to concentrate on generating premiums for investment.

This mentality, apparently, went through the whole insurance industry, and resulted in price cutting and premium wars, you know all that. That of course, has caused part of the problem today. Not only have primary carriers suffered extreme losses, the reinsurance market, once thought to be indestructible, has also been extremely adversely affected. Lloyd's of London, dominant in the reinsurance market, has, for the first time, had to call on its names, as they say, to make good on almost $160 million in losses. Wealthy individuals who, for years, had merely had to sit back and watch the profits roll in, have been asked recently to honor their pledge of all assets behind these syndicates. That means homes, cars, art works, et cetera, down to their socks.

The second major cause of the extremely tight casualty insurance market, particularly the United States, is the present state of law and judicial process in the country. We are going through a wave of mergers and acquisitions. This has created further problems. Another cause of the insurance industry's reticence—and I will summarize in a second.

Senator HECHT. Thank you very much.

Mr. ROUSSELOT. In light of these developments, we are particularly pleased that you and this committee and Congress is considering amendments to the Risk Retention Act to permit the formation of risk retention groups for other liability insurance coverage, in addition to product liability. Therefore, we are supportive of Senate bill S. 2129. We have some recommendations and amendments, which we feel would be advantageous, which we will submit for the record.

We take this opportunity to commend this subcommittee on its important work. Your subcommittee recognizing the importance of well-run financial institutions has been very helpful in asking us to testify, and we are very supportive of Senate bill S. 2129.

[The complete prepared statement follows:]

Senator HECHT. Thank you very much. Having been a board member of a financial institution for 25 years, I have watched insurance rates go up.

Mr. Daileda, it is nice that you can join us from Nevada. I am sorry you had to leave the sunny, wonderful clean air to come back East, but we welcome you here and thank you for making the long journey.

STATEMENT OF DAVID ALLEN DAILEDA, AIA, ON BEHALF THE AMERICAN INSTITUTE OF ARCHITECTS

Mr. DAILEDA. Thank you, Senator. It is going to be 93 degrees at home today.

Senator HECHT. And you and I are going to miss a good golf round.

Mr. DAILEDA. That's correct.

Mr. Chairman, my name is David Allen Daileda, AIA. I am a practicing architect with the Las Vegas firm of Harris Sharp Associates, Inc. I am a member of the board of directors of the American Institute of Architects [AIA]. Established in 1957, the AIA is the professional association representing the Nation's architects.

CRISIS IN LIABILITY INSURANCE

I appreciate this opportunity to offer the views of the AIA on the crisis in liability insurance. We commend you and your colleagues for holding this important and timely hearing. The liability crisis has had a profound impact on the ability of our members both to design decent housing and suitable living environments and contribute to the economic progress of our urban communities.

The efforts of the private sector and all levels of the government to rehabilitate multifamily rental projects, to modernize public housing and to redevelop worn out and deteriorated commercial areas are all affected by the inability of the architect to obtain liability insurance at reasonable cost. Similarly, joint efforts to rejuvenate neighborhoods through such programs as the Community Development Block Grant Program, the Urban Development Action Grant Program, the Rental Rehabilitation Program, the Urban Homesteading Program and others under the jurisdiction of this subcommittee are stymied when liability insurance disappears.

Of particular and overwhelming concern to architects is the Liability Insurance Program associated with asbestos abatement. All of the projects and programs in buildings constructed before 1972 potentially involve asbestos and insurance for asbestos abatement is simply not available at any cost.

The liability insurance crisis has been studied intensively by our institute. Most architects' premiums have at least doubled, often tripled, over the past 18 months. In fact, the liability premiums we pay are twice as high, relative to income, as those charged physicians. Over a quarter of the firms in the country are going bare, as a result. And that number is increasing.

LEGAL COSTS ARE CRIPPLING FIRMS

Our most recent claims data shows that in 1983, 44 claims were filed for each 100 insured architectural firms, but in only 7 percent of these cases did the insurance companies have to pay indemnity damages. But each claim has had to be defended. Legal costs alone have been known to cripple architecture firms. Almost 80 percent of architecture firms are small businesses, employing 10 or fewer people.

We architects recognize that the insurance industry is international and that, as a result, it would be difficult to regulate it effectively from the United States. We also recognize that the McCarran-Ferguson Act further limits the industry from the scope of Federal regulation. In this context, the AIA has explored options primarily to minimize the impact of the insurance crisis on the practice of architecture.

First, we investigated the feasibility of establishing a captive insurance program for our members. Stated bluntly, we learned that an AIA-sponsored insurance company would not prove practical. Such an insurance program could not compete with conventional insurance, and the costs alone of establishing one would overwhelm us.

The impact of tort reform on architects liability problems is also limited. Most of the claims against architects involve property damage and most tort reformers are seeking to limit personal injury claims. Our claims data show that very rarely does an architect's negligence result in personal injury. Nevertheless, some reforms being discussed have a direct bearing on the design profession.

Tort liability used to be equated to negligence. One was liable for breaching the contemporary standard of care in the performance of one's duties to another. Architects supported this definition of liability, because historically, the profession has been and continues to be committed to responsibility and accountability in providing services to our clients.

In the past few years, however, creative lawyers have been able to fashion arguments acceptable to the courts and juries that have stretched the relationship between the architect's actions and responsibilities and the alleged injury, almost to the vanishing point. Increasingly, architects and other design professionals have found themselves parties to costly suits involving circumstances over which they could not have had control, such as building failures resulting from an inappropriate and unauthorized use of an architect's drawings.

The concept behind the administration's proposal to return to fault-based liability for Government contractors should serve as a model for the return of all professional liability to a question fault in the performance of professional duty.

In order for a fault-based liability system to work, however, there must be a standard by which that fault may be measured. There are no accepted standards for the removal of asbestos. Thus a determination of fault or lack of fault in asbestos abatement cannot be made. Insurance companies, which we have all recently learned, insure certainty, not risk, and have accordingly refused to insure asbestos abatement efforts.

LIABILITY INSURANCE REFORM

Statement of

John H. Rousselot
on behalf of the
National Council of Savings Institutions

before the

Subcommittee on Housing and Urban Affairs
of the
Committee on Banking, Housing and Urban Affairs
U.S. Senate

Room 538 Dirksen Senate Office Building
May 15, 1986
9:30 a.m.

Mr. Chairman and distinguished members of the Subcommittee, I am John Rousselot, President of the National Council of Savings Institutions. I would like to give you our perspective on the crisis in the Directors and Officers liability insurance market as it affects financial institutions.

First, let me give you some background on the National Council. The Council represents approximately 600 thrift institutions. Our members' average asset size is $800 million; their average capital ratio is approximately 6%. Many of our member institutions remain in the mutual form although we have seen a significant number of conversions to the stock form over the last several years, with very strong activity in the first quarter of 1986.

The Council is the product of the merger of the National Association of Mutual Savings Banks (NAMSB) which represented approximately 400 savings banks and the National Savings and Loan League (NSLL) which represented approximately 200 savings and loan associations.

In 1972, our predecessor organization NAMSB created an off-shore reinsurance company called Drayton, Ltd. in Bermuda. It was established in response to an extremely tight insurance market, very similar to today's market. At that time, however, the scarcity was in mortgage impairment insurance — that is insurance which protects lenders in the event of earthquake or flood. Since its inception in 1972, the company has grown steadily and increased its product lines to include reinsurance of directors (or trustees) and officers liability (D&O) and blanket bond coverage. So called front companies licensed to do business in the United States have been the primary carriers on these programs with reinsurance provided through Drayton. Approximtely one third of our members, primarily mutual savings banks, have obtained D&O insurance and blanket bond coverage through this facility.

As I am sure you know, it is essential for financial institutions to be able to obtain D&O insurance if they are to attract and retain competent management and directors. In today's litigious atmosphere, those qualified to fill such positions will not serve unless they are given appropriate insurance coverage for unreasonable risks of personal liability and are protected against the very substantial costs of defending or settling actions which are not well founded.

Now, let me tell you what has happened to our members over the last year to a year and one half.

Up until about a year and a half ago, our members were offered three year D&O policies with very low deductibles and quite modest premiums. In mid-1985, all three year policies were cancelled and rewritten as one year policies. Premiums went up anywhere from 400% to 1500%. Deductibles were raised significantly in the larger

institutions. And the coverage was drastically reduced to the point that one member proclaimed that he would only be protected under the policy for suits filed by depositors alleging discriminatory practices.

Why did this happen to our members? Are they particularly uninsurable? No, in fact over the 15 years Drayton has been in existence, the loss ratio on D&O insurance for our members has averaged under 15%. Our book of business in this line has been profitable for both Drayton and our reinsurers, but our members have nevertheless gotten caught up in the industry-wide crisis that is making it almost impossible for financial institutions to maintain liability coverage.

You asked for our explanation as to the causes of the insurance industry crisis. Although by no means experts in the insurance industry, let me give you the layman's perspective on the crisis. I believe that there are four major causes to the crisis.

First, the insurance industry is a very cyclical industry. In the late 70s and early 80s the name of the game in insurance was investment income. Of course with interest rates near 20 - 22%, it seemed reasonable not to worry about underwriting for risk and to concentrate on generating premiums for investment. This mentality apparently permeated the insurance industry, and led to price cutting and premium wars, such that the premium income could never cover underwriting losses -- which few expected to happen anyway. Well, despite the rosy predictions, underwriting losses did occur. In 1984, according to the Best's Report the property/casualty insurance industry sustained $21.3 billion in underwriting losses as against net investment income of $17.6 billion, for a net operating loss of over $3.7 billion. The last time the entire industry took a net loss was in 1906, the year of the San Francisco earthquake. For 1985, net losses were expected to exceed $4 billion. Where once there were 20 to 40 companies competing to write D&O insurance, we are now down to about 5, with numerous companies going out of business altogether and others getting out of the property/casualty line of business.

Not only have the primary carriers suffered extreme losses, the reinsurance market, once thought indestructible, has also been extremely adversely affected. Lloyd's of London, the world's dominant reinsurance market has for the first time had to call on its "names" to make good on almost $160 million in losses. Wealthy individuals, who for years, had merely to sit back and watch profits roll in, have been asked recently to honor their pledge of "all assets" behind their syndicates -- and that means homes, cars, art works, minks, everything down to the socks.

The second major cause of the extremely tight casualty insurance market, particularly in the U.S., is the present state of the law and judicial process in this country. We are going through a wave of mergers, acquisitions, and hostile takeovers in this country that are generating massive litigation and almost daily judicial refinements of such corporate concepts as the "business judgment"

rule. Not only are the courts redefining the standards of care for officers and directors, but juries in the United States have gone on a binge of award granting, with the most notable being the $10 billion award in the Texaco case. In light of this uncertainty and extravagence, it is no wonder that both primary carriers and reinsurers are increasingly shying away from the United States market.

Another cause of the insurance industry's reticence to continue casualty insurance, particularly relevant to financial institutions, is the fact that the Federal deposit insurance agencies are closing greater numbers of financial institutions and bringing actions under the D&O policies. While, it may be argued that the government is not being significantly more aggressive in bringing such suits, nevertheless, it is a fact of life that the number of failed institutions has increased so considerably that there is more noticeable government activity.

Finally, the last cause I would like to mention of the tight insurance market is the problem of capacity. As indicated earlier, many insurers have suffered major losses which have reduced their surplus. "Capacity" is an insurance concept which relates the amount of premium that can be written to surplus. These days, with reduced surplus and monumental increases in premiums, an individual company's capacity is much more quickly reached -- resulting in less insurance available.

Risk Retention Amendments

In light of these developments, we are particularly pleased that the Congress is considering amendments to the Risk Retention Act to permit the formation of risk retention groups for other liability insurance coverage in addition to product liability and completed operations liability. We believe that the Act should be expanded to include D&O liability insurance and other professional liability coverages and support S. 2129 in this regard. In addition, as we understand the Act, it preempts state law to the extent necessary to facilitate the establishment of industry owned or captive insurance companies, such as Drayton Co.

As explained in the Committee report accompanying the 1981 Act,

> Because risk retention groups will be providing insurance coverage only to their members, and not to the public at large, it is believed that regulation by the chartering jurisdiction will be sufficient to provide adequate supervision of these groups. (S. Rept. 97-271 p. 13)

This is a fundamental and essential principle which, in our view, justifies the judicious federal preemption of state law that limits the ability of captives to operate among the several states. As you know there are numerous non-chartering state statutes that,in the aggregate, tend to thwart interstate operation of risk retention groups.

Under the existing act, a product liability risk retention group must obtain a charter from one of the United States or from Bermuda or the Cayman Islands (before a certain date). We are hopeful that if the act is amended, you would consider extending its provisions to provide that our existing Bermuda company would qualify under the Act.

We will be submitting for the record detailed comments on the Risk Retention Amendments Act (S.2129) which would be advantageous to our members in their effort to procure affordable and proper insurance coverage.

I would like to take this opportunity to commend the Subcommittee on its important work in this area. Your subcommittee, recognizing the importance of well-run financial institutions, has been very helpful in asking us to testify today and by providing the opportunity to submit additional information to the Subcommittee in the future.

I would be pleased to answer any questions you may have.

REQUIRE EPA TO PROMULGATE STANDARDS

Senator Stafford has introduced legislation to require the Environmental Protection Agency to promulgate such standards. We support this legislation.

Another avenue often discussed for reform legislation would eliminate the collateral source rule. As things stand now, an injured party can be fully compensated for his or her injury by insurance, yet still sue the alleged wrongdoers for a like or even greater amount. This sort of double-dipping could be eliminated, without limiting appropriate compensation for the tort victim.

You may not know that the injured construction worker who receives workers' compensation often seeks to double-dip by suing architects. Most States do not include design professionals under the workers' compensation umbrella, and because of that oversight, architects who are usually insured, are the only deep pockets left on the construction site. Generally, these suits are unsuccessful, because architects usually are not responsible for construction site safety. Nevertheless, design professionals have to undergo the expense, not to mention the wear and tear, of defending themselves.

To the extent that injured workers sue design professionals because they believe their State has not compensated them adequately for their injuries, the solution would seem to be upward adjustment of the State's worker's compensation schedule.

Senator HECHT. Your time is up. I will give you 1 minute to summarize.

Mr. DAILEDA. The insurance industry is currently regulated by the States. Tort law is determined by them as well. There is a role, however, for the Federal Government, albeit it a limited one. Senator Stafford's proposals present a focused opportunity for concrete action. Many of the other suggestions being discussed here exemplify the effect this Congress might have in resolving the insurance liability crisis.

Mr. Chairman, members of the subcommittee, there is room for change in the American civil justice system. It must evolve into a more fair, more efficient, more predictable, more effective system, and over time, it undoubtedly will.

Thank you for the opportunity today to state the architect's concerns and solutions to one of our society's most pressing problems.

[The complete prepared statement follows:]

Senator HECHT. I thank you for testifying.

One of the most important points of these hearings is to bring out information.

I just want to quote one line in your testimony about architects, which is a little-known fact. "In fact, the liability premiums we pay, are twice as high, relative to income, as those charged physicians."

This was an unknown fact. I am happy you brought that out.

Mr. Miller, would you continue.

STATEMENT OF LEONARD MILLER, CHAIRMAN, NATIONAL ASSOCIATION OF HOME BUILDERS' TASK FORCE ON LIABILITY INSURANCE, PEMBROKE PINES, FL

Mr. MILLER. Thank you, Mr. Chairman.

My name is Leonard Miller. I am a builder from Broward County, FL, and chairman of the National Association of Home Builders' Task Force on Liability Insurance.

I am happy to be here and testify on behalf of our association on builder liability. The liability crisis we are currently experiencing is something which impacts society in general and not just high risk industries. The cost increases resulting from higher insurance premiums are passed on to consumers, and in this sense, we are all consumers. Because of the broad impact, it is essential to understand these issues and to provide for reasonable solutions.

Builders protect themselves through insurance, but that option is becoming very costly and in many cases unavailable. Premiums are going up astronomically. Coverage is shrinking, and many builders, large and small, are being cut off by insurance carriers.

In January of this year, the National Association of Home Builders' president, David Smith, appointed a task force to study the liability insurance problem. As I mentioned earlier, I am chairman of that task force.

One of the first actions we took on the task force was to quantify what is happening. We surveyed our members to see where the problems were most pronounced. I have some preliminary results from the just completed survey of some 3,500 members, of whom 14 percent responded.

RESULTS OF HOME BUILDERS' SURVEY

Many builders face significant problems of cost coverage and availability of liability insurance.

Let me share some of these results with you, as reported by our builders.

First, 96 percent of those surveyed carried liability insurance; 2.4 percent of those not presently covered by insurance planned to obtain it.

Second, almost 80 percent of our members experienced rate increases during the past year. Of these, almost one in five, 18.3 percent, had increases in excess of 100 percent, and an additional 18 percent had increases of between 50 and 100 percent.

Third, almost one in four builders indicated that they were forced by their insurance carrier to accept changes. About one-third faced increased deductibles, and about one-quarter had their coverage limits reduced.

Fourth, almost one in five, 17 percent, had insurance carriers cancel their insurance during the past 3 years, and most of those cancellations occurred within the past year.

The majority of the cancellations were not due to builders as poor risks. Over 61 percent of the builders indicated that no claims were filed against their policies prior to cancellation. An additional 24 percent indicated that only one or two claims were filed prior to cancellation.

Our interpretation of these findings is that builders are bearing the consequences of what is happening elsewhere in the system.

Fifth, almost 40 percent of the builders reported that general casualty insurance is the most common type of liability coverage that presents problems, followed by property damage, vandalism, and transportation.

We have not yet been hit by the litigation explosion that has swamped other professions. Of the builders surveyed, 85 percent indicate they have not been subject to liability suits in the past 5 years. Most suits were settled out of court. Typical out-of-court settlements in court-awarded damages were under $15,000.

Since the task force has not completed its analysis of legislative proposals, I will refrain from offering specific suggestions for legislative solutions to the problem.

We are looking at the full range of tort reforms to see what makes sense. We do not believe that tort reform in and of itself will cure the problem, but we do agree that it must be part of any basic solution to the liability problems facing homebuilders.

Some of the specific things we are looking at very closely include limits on attorneys' contingency fees, alternative dispute resolution, and modification of joint and several liability.

Mr. Chairman, I would be happy to share the task force's findings with the committee once we have completed our work, and I would be happy to answer any questions at this time.

[The complete prepared statement follows:]

STATEMENT OF

DAVID ALLEN DAILEDA, AIA

ON BEHALF OF

THE AMERICAN INSTITUTE OF ARCHITECTS

BEFORE THE

HOUSING AND URBAN AFFAIRS SUBCOMMITTEE

OF THE

BANKING, HOUSING & URBAN AFFAIRS COMMITTEE

OF THE

U. S. SENATE

MAY 15, 1986

Mr. Chairman and members of the Subcommittee, my name is David Allen Daileda, AIA. I am a practicing architect with the Las Vegas, Nevada, firm of Harris Sharp Associates, Inc., and a member of the Board of Directors of The American Institute of Architects (AIA). Established in 1857, the AIA is the professional association representing the nation's architects.

I appreciate this opportunity to offer the views of the AIA on the crisis in liability insurance. We commend you and your colleagues for holding this important and timely hearing. The liability crisis is having a profound impact on the ability of the architect both to design decent housing and suitable living environments, and to contribute to the economic progress of our urban communities. The efforts of the private sector and all levels of the government to rehabilitate multi-family rental projects, to modernize public housing, and to redevelop worn-out or deteriorated commercial areas are all affected by the inability of the architect to obtain liability insurance at reasonable cost. Similarly, joint efforts to rejuvenate neighborhoods through such programs as the Community Development Block Grant program, the Urban Development Action Grant program, the rental rehabilitation program, the Urban Homesteading program, and others under the jurisdiction of this Subcommittee are stymied when liability insurance disappears.

Of particular and overwhelming concern to architects is the liability insurance problem associated with asbestos abatement. All of the projects and programs in buildings constructed before 1972 potentially involve asbestos, and insurance for asbestos abatement is simply not available at any cost.

State of Affairs for Architects

The liability insurance crisis has been studied intensively by our Institute. Most architects' premiums have at least doubled, often tripled, over the past eighteen months. In fact, the liability premiums we pay are twice as high, relative to income, as those charged physicians. Over a quarter of the firms in the country are "going bare" as a result, and that number is increasing. Our most recent claims data show that, in 1983, 44 claims were filed for each 100 insured architectural firms. In only seven percent of these cases did the insurance companies have to pay indemnity damages. But each claim has had to be defended. Legal costs alone have been known to cripple architecture firms; nearly 80 percent of those firms are small businesses, employing less than ten people.

The issue is complicated, and to facilitate your deliberations, I ask permission to submit for the record two special issues of the AIA's newsletter, a survey of the design professional insurance industry, and a liability strategy guide developed by the AIA that offers various legislative remedies for states.

The Architect's Response

We architects recognize that the insurance industry is international and that, as a result, it would be difficult, if not impossible, to regulate it effectively from the United States; Lloyd's of London cannot be commanded by a U.S. court or legislature to continue to offer reinsurance where it chooses not to do so. We also recognize that the McCarran-Ferguson Act further limits the industry from the scope of federal regulation and that basically, insurance regulation, if at all, must come from the states.

In this context, the AIA has explored options primarily to minimize the impact of the insurance crisis on the practice of architecture. First, we investigated the feasibility of establishing a "captive" insurance program for our members. Stated bluntly, we learned that an AIA-sponsored insurance company would not prove practical. Such an insurance program could not compete with conventional insurance and the costs alone of establishing one would overwhelm us.

As you may know, the costs of a captive program are typically higher than the costs of conventional insurance. A captive usually pays more for reinsurance than the larger, conventional insurer does. Moreover, a new insurer is often a victim of "adverse selection." That means that captives are likely to attract only those risks that other insurers have turned down. Therefore, a captive will have more losses than other insurers, forcing it to charge higher rates and driving good accounts even further away. We also learned that when market rates fall, as the cyclical nature of the insurance market ensures they will, there is a great incentive on the part of participants to abandon the association's program and seek the lower premiums that conventional insurers once again offer.

Finally, we learned that capitalization costs can exceed millions of dollars. Senators Danforth and Kasten have introduced The Risk Retention Amendments of 1986, S. 2129, to reduce the administrative costs of setting up a captive. With capitalization costs as high as $10 million, however, their effort, though appreciated, will not help us.

Tort Reform

The impact of tort reform on architects liability problems is alao limited. Most of the claims against architects involve property damage, and most "tort reformers" are seeking to limit personal injury claims. Our claims data show that very rarely does an architect's negligence result in personal injury. Nevertheless, some reforms being discussed have direct bearing on the design profession.

Tort liability used to be equated with negligence. One was liable for breaching the contemporary standard of care in the performance of one's duties to another. Architects supported this definition of liability because historically the profession has been and continues to be committed to responsibility and accountability in providing services to clients.

In the past few years, however, creative lawyers have been able to fashion arguments acceptable to the courts and juries that have stretched the relationship between the architect's actions and responsibilities and the alleged injury almost to the vanishing point. Increasingly, architects and other design professionals have found themselves parties to costly suits involving circumstances over which they could not possibly have control, such as building failures resulting from an inappropriate and unauthorized use of an architect's drawings.

The concept behind the Administration's proposal to return to fault-based liability for government contractors should serve as a model for the return of all professional liability to a question of fault in the performance of professional duty.

In order for a fault-based liability system to work, however, there must be a standard by which that fault may be measured. There are no accepted standards for the removal of asbestos. Thus a determination of fault or lack of fault in asbestos abatement cannot be made. Insurance companies, which we have all recently learned, insure certainty and not risk, have accordingly refused to insure asbestos abatement efforts.

Senator Stafford has introduced legislation (S. 2083 and S. 2300) to require the Environmental Protection Agency to promulgate such standards. Hearings are being held today on these bills before the Subcommittee on Toxic Substances. We support this legislation as a necessary step towards risk containment in the potentially menacing field of asbestos abatement. If liability is clearly based on fault, and if standards exist to define that fault, logic and certainty might be reestablished in the asbestos arena and the insurance industry may reenter the market place.

Another avenue of often-discussed reform legislation would eliminate the "collateral source rule." As things stand now, an injured party can be fully compensated for his or her injury by insurance, yet still sue the alleged wrongdoers for a like or even greater amount. This sort of "double-dipping" could be eliminated, without limiting appropriate compensation for the tort victim.

You may not know that injured construction workers who receive workers' compensation often seek to "double dip" by suing architects. Most states do not include design professionals under the workers' compensation umbrella and, because of that oversight, architects, who are usually insured, are the only "deep pockets" left on the construction site. Generally these suits are unsuccessful because architects usually are not responsible for construction-site safety. Nevertheless, design professionals have to undergo the expense, not to mention the wear and tear, of defending themselves. To the extent that injured workers sue design professionals because they believe their state has not compensated them adequately for their injuries, the solution would seem to be an upward adjustment of a state's workers' compensation schedule to provide fair and compassionate relief to all workers injured on the job site, and not an increase in court and legal costs engendered by unsuccessful suits.

* * *

The insurance industry is currently regulated by the states. Tort law is largely determined by them as well. Many changes crucial to overcoming the current liability insurance crisis, and to avoiding a repeat crisis when the next market cycle comes around, will necessarily be made, and in some cases have already been made, by state legislators.

There is a role, however, for the federal government, albeit a limited one. Senator Stafford's proposals present a focused opportunity for concrete action to mitigate the dangers posed by asbestos and by an insurance industry that fears the legal consequences of abating it. Many of the other suggestions being discussed here today exemplify the affect this Congress might have in resolving the insurance liability crisis.

Mr. Chairman and members of the Subcommittee, there is room for change in the American civil justice system. It must evolve into a more fair, more efficient, more predictable, more reasonable and more effective system, and over time it undoubtedly will. Thank you for the opportunity today to state architects' concerns and solutions to one of our society's most pressing problems. I would be pleased to respond to any questions you may have.

STATEMENT OF
THE NATIONAL ASSOCIATION OF HOME BUILDERS
before the
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

on
LIABILITY INSURANCE

MAY 15, 1986

Mr. Chairman and Members of the Subcommittee:

My name is Leonard Miller and I am a builder from Pembroke Pines, Florida, and Chairman of the NAHB's Task Force on Liability insurance. I am happy to be here and testify on behalf of the National Association of Home Builders, a trade association representing more than 140,000 members, on builder liability.

The liability crisis we are currently experiencing is something which impacts society in general -- and not simply high risk industries. The cost increases resulting from higher insurance premiums are passed on to the consumers -- and in this sense, we are all consumers. In the building industry we are consumers of lumber,

concrete and other products used to complete a construction project. The ultimate consumer of these products is, of course, the homebuyer and the renter. As such, it is essential to study and understand this issues and to provide reasonable solutions.

Building is a high risk business. From the time a builder purchases land to the time he actually completes the project, many things can go wrong. A builder can run into a regulatory snag that delays completion of a project for months or even years, or interest rates could rise and cause a change in the sales market. As builders we are aware of these types of risks at the onset of our plan. However, hidden risks continue to haunt us after a home is sold, and in this respect a builder may be held liable to a second or third owner -- even if structural damage occurs as a result of some then unknown factor years after the building has been completed.

Builders protect themselves through insurance, but that option is becoming very costly and in many cases unavailable. Like many other sectors of the business community and the public sector, recent trends with liability insurance pose serious business problems for builders. Premiums are going up astronomically, coverage is shrinking, and many builders, large and small, are being cut off by insurance carriers.

Undoubtedly, you have already heard horror stories. We too have ours. For example, I recently heard of a property management firm whose umbrella insurance went from $4,200 to $42,000 in one year. The NAHB Liability Task Force wanted hard facts. Therefore, one of our first actions was to quantify what is happening.

We surveyed our members to see where the problems were most pronounced. I have some preliminary results from a just completed survey of some 3500 members of whom 14% responded. Many builders face significant problems of cost, coverage and availability of liability insurance. Let me share some of these results with you as reported by our builders.

1. Liability insurance is an essential part of our business. 96% of those surveyed carried liability insurance. 2.4% of those not presently covered by insurance plan to obtain it.

2. Almost 80% of our members experienced rate increases during the past year. Of these, almost one in five (18.3%) had increases in excess of 100%. An additional 18% had increases of between 51 and 100%.

3. Almost one in four builders indicated that they were force by their insurance carrier to reduce coverage. About one-third faced increased deductibles. About one-quarter had their coverage limits reduced.

4. Almost one in five (17%) of the builders indicated that the insurance carriers cancelled insurance during the past three years, with most cancellations occurring within the past year. Most cancellations were not due to builders as poor risks. Over 61% of the builders indicated that no claims were filed against their policies prior to cancellation; an additional 24% indicated only one or two claims were filed prior to cancellation. We feel that builders bear

the consequences of what is happening elsewhere in the system. I'll return to this point shortly.

5. Almost 40% of the builders reported that general casualty insurance is the most common type of liability coverage that presents problems; this was followed by property damage (18%), vandalism (15%) and transportation (12%).

The insurance crisis affects builders of all sizes. Small volume builders -- those building 10 or fewer homes a year -- are being required to pay minimum premiums. Last year these builders could obtain $300,000 worth of liability coverage for $400 - $600 a year. They are now forced to accept a minimum premium of $1,500 for the same amount of coverage. And at the other end of the size specturm, large builders are having trouble obtaining liability coverage totaling more than $5 million. In some cases, insurance companies are dropping liability coverage for builders from $10 million to $5 million and at the same time, doubling or tripling their premiums. As you are aware, this not a story which is peculiar to the building industry.

We have not yet been hit by the litigation explosion that has swamped other professions. Of builders surveyed, 85% indicate that they have not been subject to liability suit in the past 5 years. Most suits are settled out of court. Typical out of court settlements and court awarded damages were under $15,000.

I can speak for the thousands of reputable builders in our industry. We work for satisfied home buyers. Many of us live in the same community where we build and to which we are committed.

and regulators are hesitant to use or approve the use of such products out of fear of being sued. The result will be to discourage the start up of new businesses and associated new jobs so critical to the American economy.

Conclusion

In conclusion, I would like to thank you, Mr. Chairman and members of the Committee for the opportunity to testify on the subject of builder liability. If there is one thought I can emphasize, it is that liability insurance availability and affordability are problems that need solutions. At the same time, we must think constructively about reforms of more basic causes of the liability problem - reform of the tort system. I don't think this crisis is going to disappear on its own in the near future. There are just too many inconsistencies and variables involved -- and that only ensures further confusion.

NAHB will be happy to share with the Committee our Task Force findings once they have been completed. Mr. Chairman, I will be happy to answer any questions you or the members of the Committee would like to ask.

Senator HECHT. Thank you. We will submit them to Senator McConnell.

It is kind of a horror story listening to you, and your industry is probably one of the most important industries in America because everything seems to revolve around the housing industry.

So I thank you for your testimony.

You cited removal of due care as an issue which places strict liability on the builder. This would appear to have very broad implications. In addition, the courts appear to be trying to guarantee no risk in the housing industry.

IMPACT ON COST OF HOUSING

How do you feel a continuation of this policy will impact the cost of housing in America?

Mr. MILLER. It is very obvious what is happening today is primarily that our subcontractors in many cases are unable to get coverage at all, particularly those involved in hazardous trades, such as insulating contractors, workers on scaffolding, plasterers, painters, people of that ilk.

We are finding that if these subcontractors are made to go bare—in other words, have no coverage at all—that they are coming in with tremendous increases in their proposals to us, which of course is passed on to the consumer.

So obviously the cost of housing is going to go up appreciably.

In addition, there are many general contractors today who are absolutely refusing to take on certain types of work; in particular, condominium construction, where there is a tremendous number of suits filed for various supposed liability problems. Many people are leaving that industry entirely because of the risk.

I think, therefore, that the cost of housing, of those particular items would go up immeasurably.

Chairman **Hecht**. You stated in your testimony that builders are consumers of the products that go into building homes.

Are the suppliers of these products having similar liability insurance problems, and are their costs being passed on to you?

Mr. **Miller**. I can't say in fact that they are, but I assume that is the case. I think that in this day and age, when inflation has been relatively low and stable, we are still getting tremendous increases in the cost of appliances and things of that nature.

I haven't investigated it, so I don't want to make a flat statement. But I think some of that may be coming from their exposure to liability suits.

Senator **Hecht**. How has your participation in the homeowner's warranty program had an impact on your insurance rates?

Mr. **Miller**. The homeowner's warranty program, in my personal experience, has been one of the best items I have really done in my business. Providing that insurance has really resulted in disputes being handled in a very orderly manner, mostly through the mediation process that is required in that policy. Therefore we find that through mediation and arbitration we are able to solve a very, very high percentage of these disputes. I would say as many as 95 to 98 percent of the disputes are handled because this policy is being provided to our buyers.

Senator **Hecht**. On the subject of new technology, are builders hesitant to use new products because of the liability problem?

Mr. **Miller**. Very definitely. Obviously, what is happening now with the lawsuits that have been filed on radon gas, on certain types of insulation, on almost any new technology that is being contemplated to go into our industry, causes concern among contractors.

We are now in the process of creating a new product called the "smart house." It is a product of the research foundation of the National Association of Home Builders. This project incorporates tremendous new technology, and one of the main fears we have is that some of this new technology may be impeded because of the liability problems that are out there.

Senator **Hecht**. One last question, the mega question or whatever it is.

In your mind, what percentage of the cost of a house is tied up in liability insurance all down the line?

Mr. **Miller**. I don't think, Mr. Chairman, that I can answer that. I wish I could. I will try to get you the answer.

Senator **Hecht**. I am trying to figure that out. I would like to give it to Senator McConnell. I think we might be very, very surprised at that figure.

Mr. MILLER. I will try to provide the committee with that information.

[See p. 203.]

Senator HECHT. Thank you.

Mr. Daileda, you mentioned alternative dispute settlement methods as a low-cost means of speeding settlement of disputes.

In what way is this beneficial for a professional association such as yours?

Mr. DAILEDA. Well, Senator, the alternate methods that could speed the resolution of a problem and ultimately save the architect and the professional the time and the effort, not only the dollars for defense but the time and the wear and tear that it takes to be involved in the defense of an issue.

So ultimately, productivity is lowered due to the time that is consumed by being involved in a lengthy settlement.

EFFECTS OF LIABILITY INSURANCE ON PROGRAMS

Senator HECHT. You observed that many of the programs overseen by this subcommittee, such as the rehabilitation of multifamily housing, the modernization of public housing, and the rejuvenation of neighborhoods, involve the work of architects.

What implications do you see for the funding levels of these programs on the Federal level should architects face rising insurance costs?

Mr. DAILEDA. As insurance costs rise, architects have no choice but to pass that on to their clients, as everyone else does, or to simply not do the work. So the programs will either have to have increased budgets in order to hire the architects, or they will have to cut back the amount of projects, the amount of things that can be done with that funding.

Senator HECHT. I won't put you on the spot like I did Mr. Miller, but in the future if you could work up some figures of what the cost is percentagewise, I think it would be very, very interesting.

Congressman, how has the insurance crisis affected your assessment of potential borrowers; that is, should a business be unable to obtain liability insurance or only at extreme cost, does that affect your assessment of them as a loan customer?

Mr. ROUSSELOT. So far, Mr. Chairman, it hasn't caused tremendous problems. For instance, in the case of D&O insurance, that has only occurred in the last 1½ years or so. This tremendous increase in the lack of full coverage that we had on previous occasions—so far has not affected the borrowing costs.

But I think in the future what may happen is that lending institutions, if they find that their borrowers are being overly attacked in court, will probably not lend in that area.

Senator HECHT. In your testimony you are a proponent of expanding risk retention groups to include directors and operators liability insurance.

What kind of savings do you anticipate for financial institutions should captives for D&O insurance be sanctioned?

Mr. ROUSSELOT. Obviously, because they would be able to be covered. I can't give you a dollar amount.

If you would like me to come back and respond, I will try to do that on an estimate basis.

Senator HECHT. Yes, at a later time.

Mr. ROUSSELOT. But I find it pretty hard to just comment off the cuff.

Senator HECHT. You know, we have many thousands of savings and loan institutions, 14,500 commercial banks in America today.

If the situation continues on directors' liabilities, do you see this as a big instrument in future financial institutions?

Mr. ROUSSELOT. First of all, the first problem will be getting competent people to serve as officers or on the board of directors. You just won't be able to get them because they will become overly concerned with that liability coverage.

What the ultimate cost will be to the borrower is a little difficult to say, but it is obvious that the management of the institution will probably be affected.

Senator HECHT. Wouldn't this have an effect on minimizing the amount of institutions in America and more mergers and fewer financial institutions?

Mr. ROUSSELOT. It certainly might affect more institutions finding a way to merge with others so that they could cover the liability phase.

AGENCY SUITS

Also, I didn't get a chance in my testimony to mention another area of concern, suits brought by the regulatory bodies of our own Government. That has, of course, been kind of a deterrent, you might say, in the field and has caused many lending institutions to move away from given areas.

Senator HECHT. I agree with you on that very, very much.

Thank you.

Mr. Gaskins, many have claimed that there is no insurance availability crisis. The experiences of your industry seem to contradict this assertion.

Could you comment?

Mr. GASKINS. Mr. Chairman, there is absolutely a monumental crisis. We have appraisers operating in some States today where they cannot get any kind of errors and omissions insurance.

Of the three or four, maybe literally a half dozen at most that are offering some form of errors and omissions insurance for real estate appraisers, the majority would offer programs only in 23 States in one instance, 26 States in another instance, but there isn't a good, viable program being offered for all States right now.

Senator HECHT. How much of your industry's insurance availability problem can you attribute to poor appraisal practices?

Mr. GASKINS. We believe there is a certain amount of that. We believe that the cure would be an encouragement of the regulation of appraisers.

We have developed a model certification bill that we have presented to various State and Federal agencies to try to encourage them to regulate appraisers and to enforce the standards that they should adhere to, which right now are nonexistent. But it is a relatively small portion in terms of how it applies to errors and omissions because the judgments simply aren't there.

It is simply a case——

Senator HECHT. I am being reminded, this is one of the few times since I have been a Senator that industries are asking to be regulated.

Mr. GASKINS. I had to be the one.

Senator HECHT. Well, you know, that is part of our duties as Members of Congress, to address the situation and be updated on current situations, and we must adjust our sights, and obviously from hearing this testimony, we had better start adjusting some sights.

As we develop solutions here at the Federal level, what specifically should we keep in mind when addressing the problems of the real estate appraisers?

Mr. GASKINS. I would say there are several things that should specifically be considered.

One is that we need a program that would fine a plaintiff whose case is judged frivolous and require that they pay legal fees and court costs of the defendants.

I think we should limit the contingency fee of trial lawyers on errors and omissions insurance.

We believe there should be some type of a cap to the punitive damage, and we really need a reform of the concept of damages so that an award of damages will be based on the defendant's share of negligence rather than ability to pay, which is indicated by the appraiser who gets named automatically every time some suit comes out against a land deal or an investment deal.

The reason I indicated earlier that I thought that the ultimate solution lies with judicial reform is that if insurance companies can determine that there is a potential limit to their liability and that actions can and will be taken by the Government to reduce excessive litigation, I think that the competitive nature of the insurance industry will take hold and that some of this will start to settle.

But the way it lies right now, I think that until that action takes place, dealing with the States is leaving us up in the air.

Senator HECHT. If you would excuse a personal reference, but over the years as the director of a bank, obviously if there is a loan default the customer first says it was a flawed appraisal. Obviously, I wouldn't have bought the property.

Then the bank will say it is a flawed appraisal because if it wasn't the man could pay his mortgage.

This must be developing all around America more and more.

Would you address that?

STATUS OF AN APPRAISAL

Mr. GASKINS. That is the particular problem we are trying to address nationally. As a matter of fact, our entire media advertising program is directed to it.

The problem lies in that an appraisal is not a guarantee of value. It is an estimate of value, and it is based on conditions that are placed upon the appraiser by the client.

To take a dollar bottom line value and use it for purposes other than for what it was designed and paid for is inappropriate.

There are so many limiting conditions and aspects to an appraisal report beyond just when they say, gee, you said it is worth $50 and 3 years later I can't get my $40. It just doesn't work that way.

What we have got to do is educate the users of appraisal services as to what they should be requiring and asking of appraisers.

Senator HECHT. It's absolutely true that you're being held accountable too often for advertisement.

Senator Sasser, did you have an opening statement, or did you want to ask some questions of the witnesses?

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. Thank you, Mr. Chairman.

I want to say at the outset that these hearings on the availability and cost of commercial insurance are invaluable in our efforts to combat what I perceive to be a genuine crisis.

I'm sure, as you have heard today from other witnesses, there is still some dispute over the true nature and extent of the problem. That dispute was evident when I chaired the first field hearings of the Senate Small Business Committee on this issue last year.

Frankly, I discovered a wide divergence of views on both the roots and extent of this problem. In an effort to gather more information about this crisis, I conducted an informal survey of the small business community in my State. And I think you'll find the results of this survey both interesting and quite troubling.

Of the 1,500 to 2,000 small business people I surveyed, nearly 40 percent of those who responded have seen their premiums increase by more than 100 percent over the last year.

Also, 22 percent reported increases of 100 to 250 percent in premiums, and a very disturbing 18 percent responded that their premiums had shot up more than 250 percent in 1 year.

Those who answered the survey made it clear that they cannot afford to simply sit back and wait for the market to correct the situation. Nearly 75 percent of these respondents are experiencing or were experiencing reduced profits because of increased liability insurance costs.

And 10 percent of the respondents were considering going out of business, and 10 percent of the remainder are going to stay in business. But 10 percent of those who are staying in business say they are going to go bare. They're going to forego any insurance coverage at all.

So I think, clearly, corrective action has to be taken to prevent any further economic injury.

Mr. Chairman, I might say that, before coming to the Senate, I was a trial attorney for 15 years. And I represented insurance companies as opposed to representing the plaintiffs.

So I think I have an understanding of the problems that insurers have in a court of law. It is clear to me that there are some problems in our civil court system. But I'm sure that most will agree that focusing on the court system alone will not solve all the problems in the commercial insurance industry.

I believe there are problems in other areas and not just in the courts. If remedial action is to be taken, I think, frankly, that we need to look at all the options.

For example, some claim many large insurance companies are largely responsible for the crisis. While no one wants to see the Federal Government begin regulating the insurance industry—and I'm the last to want to see that happen—the Federal Government could use some of its authority under the McCarran-Ferguson Act to start exploring possible antitrust violations by some of the large insurance carriers.

In addition, we need to start thinking about those who are adversely affected by this crisis. Risk retention legislation, discussed today, I think is a step in the right direction.

And while modifications of that measure may prove necessary, I believe it's an important tool for many companies and others that are now struggling under the strain of excessive insurance premiums.

Mr. Chairman, let me conclude by saying that many business leaders, in fact, virtually all business leaders—not just small business—business leaders across the board that I've talked with seem to agree that a multidimensional approach to solve this crisis is needed.

They stress that many of these actions are appropriate perhaps more at the State level than they are at the Federal level.

But others are properly Federal concerns. So I appreciate your calling this hearing, Mr. Chairman. I have reviewed the statements of some of the witnesses in advance and look forward to hearing from further witnesses.

Senator Hecht. Thank you, Senator Sasser. Thank you for your input.

Witnesses this morning include representatives for the insurance companies, business people, and bankers. So we've got a wide divergence of views about this business.

One point that everyone is making: There is a crisis and we have got to come to grips with it.

Senator D'Amato.

STATEMENT OF SENATOR ALFONSE D'AMATO

Senator D'Amato. I want to extend the committee's gratitude to the distinguished panel of witnesses who have come today to discuss the affordability and availability of liability insurance for local governments, housing industries and transit systems. I would like to welcome Dennis Fitzgerald, executive director of the Capital District Transit Authority of Albany, NY, who will be testifying today.

Staggering increases in liability insurance rates pose a severe challenge to the people, businesses, and in fact, the entire economy of this country. In 1985, Americans paid $98.1 billion in liability insurance premiums, a staggering 60-percent increase over what we paid just 2 years previously in 1983. In New York, these increases have forced cutbacks in the operations of school districts, day care centers and, most prominently, municipalities, and transit operations.

An unfortunate example of the effect of the crisis involves a small upstate town, Schaghticoke, NY, population 7,090. This town fell victim to Utica Mutual Insurance Co.'s cancellation of liability insurance for 229 municipalities last August. It finally obtained insurance—but at an outrageous increase of 400 percent for one-third the amount of coverage and subject to cancellation on just 30 days notice.

New York City has also felt the effects of the quantum leap in the cost of insurance. For example, the tramway running between Roosevelt Island and Manhattan recently stranded some 3,000 commuters—in effect, inviting them to find alternate transportation—when it stopped service in February. Its insurance premium jumped from $677,000 to more than $3 million a year.

Although there is a great debate on what parties are responsible for this morass, I think it useless to engage in finger pointing. Hopefully, during this morning's hearings we can begin to determine the real reasons for the liability crisis and begin to find an adequate solution ~~to our dilemma.~~

Although many legislative proposals have been introduced by my colleagues, we will focus on those that affect individuals and institutions within the scope of this committee's jurisdiction. I am certain that our witnesses will assist us in our efforts to discern the nature and scope of the problem and comment on the legislative proposals before us this morning. Careful consideration and deliberation should be given to the proposals introduced by my colleagues and the administration. Although reasonable people can differ on the specifics of a resolution to the insurance crisis, we should not let these disagreements deter our efforts to arrive at a coherent agenda for resolving this crisis. Insurance needs must be met—reasonably and affordably.

I welcome our witnesses and look forward to hearing their views on this pressing issue.

Senator Hecht. Senator Cranston had another committee to attend. He left some questions for each of you for the record. You'll be notified and we'll ask you to respond.

I thank you very much for taking the time to come here today. Many of you have traveled a long way. I feel it's in the best interests of our country, and thank you very much.

The next panel will please come up; Dennis Fitzgerald, MaryAnn Russ, and Richard Y. Nelson. Public Housing and Mass Transit.

With the first panel, I'll ask you to limit your testimony to 5 minutes and summarize. The entire testimony will be made part of the record.

Mr. Dennis Fitzgerald.

STATEMENT OF DENNIS FITZGERALD, EXECUTIVE DIRECTOR, CAPITAL DISTRICT TRANSPORTATION AUTHORITY, ALBANY, NY

Mr. Fitzgerald. Good morning, Chairman Hecht, Senator Sasser. My name is Dennis Fitzgerald My entire statement will take less than 5 minutes.

I am executive director of the Capital District Transportation Authority of the Albany-Schenectady-Troy area of New York State.

Recognizing that problems do arise from time to time that could result in law suit, we have sought to find reasonable solutions for both the home owner and the builder through the use of warranty programs. In 1974 the NAHB founded the Homeowners Warranty (HOW) program. HOW is available to builders who pass a rigid screening procedure for competence, financial stability and a good record of customer service. HOW provides warranty/insurance protection to its home owners for 10 years from the time the homeowner moves into a new home.

Specifically, under the HOW program the builder offers a warranty for one year on all workmanship and materials, and for two years on all the major systems in the house (plumbing, electrical, duct work, etc) as well as major structural defects on the home. In years three to ten, the homeowner receives insurance protection against major structural defects. Should the builder go out of business during the first two years, the insurance would cover any warranty defects. While this provides substantially more protection for both builders and buyers than uninsured builder warranties, builders are still exposed to many of the types of liability that the program does not cover.

For example, HOW covers only express warranties which spell out the builder's liability in terms of construction defects. Such warranties, as opposed to implied warranties, are less open to new and imaginative expansion by a growing number of state courts.

But HOW policies can only cover consumer or buyer complaints of specific defects. They do not cover builders against job-site injury or against owner claims for damages suffered as a result of faulty or defective appliances such as furnaces and water heaters. These areas are what have really caused the problems for home builders.

I wish we could report that all is well in the courts as far as builders are concerned. We see storm clouds coming. Many builders are concerned that the liability explosion that has hit other professionals and business will soon hit us. We already see how the courts are expanding our liability through extension of legal doctrines pertaining to implied warranties and the search for the "deep pocket" to redress any injury whether or not the builder is negligent or otherwise at fault.

Let me give you an example. A Wyoming builder built and sold a home in 1969. The original owners regraded the hillside property, added a patio and sold the home two years later. The second owners lived in the house for six years before a mudslide damaged the foundation of the house. The second owners took the case to court in 1979. The original owners were freed from any liability even though they regraded the property, exposing the home to a potential mudslide in heavy rain. The Court also struck down Wyoming's ten year statute of limitations. Consequently, the builder was forced to pay thousands of dollars to repair the home.

Negligence has traditionally served as the basis for recovery in actions brought against home builders for loss arising from defective construction of a home. To establish liability, the homeowner must show that (1) the builder owed them a responsibility - a duty of care;

(2) the builder did not fulfill the responsibility; (3) the homeowner sustained damages; and (4) the builder's failure to fulfill his responsibility was the immediate cause of the homeowner's damages.

Negligence can result from either an express or implied warranty on a home. An express warranty is actually written into the contract or a separate document that is incorporated into the contract. If the builder doesn't live up to the terms, then the buyer can sue for a breach of that express warranty. Implied warranty is quite different and its meaning varies from state to state. When a home is built, the builder implicitly warrants that the house is fit for habitation. Minor defects in the home that do not affect the livability of the house do not technically breach the warranty.

Some state courts have held that builders also warrant good workmanship. Potentially, that warranty can cover any defect in the home, minor or not -- any defect which the judge says does not meet the standards of good workmanship. Builders have been found liable for such things as shrinkage of exterior siding, cracking foundations, wet basements, leaking roofs and defective septic systems. There are also cases where defective air conditioning and heating systems have been brought in as a breach of the implied warranty. To the extent that a builder is negligent, liability should lie. Some courts, however, are straying away from fault based negligence.

A 1967 South Dakota case, Waggoner vs. Midwestern Development, Inc., paved the way for implied warranty and strict liability. In Waggoner, the homeowner sued the builder for damages caused by water seeping into the basement of the house. The court ruled that there was no evidence that the builder knew of a spring and underground water on the property, and that the appearance of the area would not have alerted the builder to these conditions. Thus, an action in negligence could not be maintained. However, the court did say there was an implied warranty by the builder of reasonable habitability and workmanship in the sale of the home. Proof of the breach of this implied warranty is sufficient to justify recovery of damages irrespective of fault or negligence on the part of the builder. So the key issue becomes not whether the builder used due care when building the home, but simply whether the home was defective. The removal of due care as an issue places strict liability on the builder.

We see this expansion of court doctrine to the point where recovery can occur without any fault on the part of the defendant as very dangerous to the consumer's interests. A court guarantee of no risk will force many good builders out of the business and/or raise the price of housing to cover the builder from law suit. We need a better balancing of risks between all parties.

According to the insurance companies, a major contributor to rising premium costs, reduced coverage and cancellations is the high payouts insurance companies make because of recent court trends to pay high awards and look for the deepest pocket. The insurance companies point to reforms in the tort system as a necessary step to deal with these problems. As insurance companies reassess their financial positions and adjust rates and coverage accordingly, homebuilders are swept along even though we are far better risks than other businesses.

We are looking at the full range of tort reforms, both at the federal and state levels, to see what makes sense. While we do not believe that tort reform in and of itself will cure the problem, we do agree that it must be part of any basic solution to the liability problems facing home builders. We want reforms that balance the justifiable concerns of the consumer and the needs of the business community.

Some of the tort reform proposals we are now studying cover reasonable limitations on non-economic and punitive damages, use of periodic payments for large judgments, and limits on attorneys contingency fees. Alternative dispute resolutions could provide the option of expediting the settlement of some liability claims and have been given legislative attention both separately and as part of other tort reform packages.

Without going out on a limb, I think I can safely state that the judicial system and society in general would benefit from elimination of frivolous lawsuits and undue delay. Perhaps one way to deal with this particular problem is to establish a system for alternative dispute resolutions whereby two willing parties can come to an agreement and avoid a prolonged judicial process - and save on attorney fees as well.

The Task Force has also been looking at a modification of joint and several liability. Too often, the so called "deep pocket" pays full costs when that entity might bear only 1% of the responsibility for an injury or occurrence. Payment in proportion to fault would appear to be more equitable than searching out a party with the financial capabilities of bailing out other parties of the suit who may have been 99% at fault, but who don't have the financial backing to pay their share of the judgement.

Reinsurance is also a problem. Many reinsurers have gone out of business, or in the case of foreign companies, have become cautious of the U.S. market because of high jury awards. Reinsurers are important to the industry because they provide back-up coverage when primary insurance is exhausted.

Senator Kasten's bill (S. 2129) would extend the Product Liability Risk Retention Act of 1981 to cover businesses and state and local government. This would allow associations, businesses, corporations, partnerships, hospitals, schools, universities and state and local governments to form groups for self insurance and provide liability insurance at lower rates. We encourage the Senate to act favorably on this legislation when it comes to the floor. We feel confident it will alleviate some of the problems associated with rapidly escalating costs and abrupt cancellation of policies.

Finally, we are concerned that fear of liability suits will hinder the development of new technologies for use in our homes and places of work. This will deny homeowners and renters the benefits of better products and designs. It is also an unhealthy result if businesses are hesitant to introduce new products for use in our homes, and builders

Our system carries 14 million passengers per year on 240 buses, and employs about 475 people.

I am a member of the American Public Transportation Association's liability insurance task force. APTA is an international organization of transit systems and related organizations; 95 percent of those using public transportation in the United States are carried by APTA member companies.

REELING FROM HIGH LIABILITY INSURANCE

Mass transit is being severely affected by a dramatic increase in tort litigation. Like many other industries, we are reeling from extraordinarily high liability insurance costs.

Last year, APTA surveyed its members and found that nearly 70 percent of the responding transit systems were encountering severe difficulties in securing adequate liability coverage at renewal time.

And for the liability insurance coverage which is available, costs have soared. Mass transit has typically experienced rate increases from 200 percent to over 1,000 percent.

Casualty/liability insurance could rapidly become the second most costly operating expense in our system, after labor. In my system in Albany, for example, our annual insurance premium increased in 1 year from $98,900 to $421,500, while our self-insured retention at the same time increased over 1,000 percent. And our ceiling for coverage dropped by $5 million.

We are told that we can expect a minimum of another 50 percent increase this year in August when we renew.

All of this comes at a time of proposals to decrease Federal financial support for transit systems and State and local budgets are increasing and cannot be expected to provide for extraordinary increases in insurance premiums. This industry is simply unable to absorb further comparable increases in liability insurance and liability-related expenses without jeopardizing the very nature of the business itself.

In fact, some systems even faced the suspension of operations because of the lack of insurance coverage.

Further, public transit bears the additional costs of being perceived by plaintiffs as having unlimited resources to pay claims—the so-called deep pockets syndrome. But, unlike other governmental defendants, public transit is frequently not covered by State immunity nor tort claims provisions.

Public transit typically faces the same liability exposure as private corporations, but we are increasingly without the resources to pay these costs.

Therefore, when reform efforts are directed at the continuation of essential government services through immunity or tort claims provisions, either at the State or the Federal level, it is important that public transit not be left out.

Our members have expressed support for efforts which are being directed at the State and Federal level at tort law reform.

Our liability insurance task force, which was formed to deal with this crisis, has identified tort law reform as a priority area of concern. We are monitoring State and Federal developments in this area so that our members are ready to participate in those solutions which may lower costs associated with liability risks.

For example, the comprehensive tort reform law recently enacted in the State of Washington was supported by our association.

Furthermore, APTA members have expressed support for the efforts presently underway to deal with tort law reform from a broad perspective rather than on an industry by industry basis.

GROUP SOLUTIONS TO INSURANCE PROBLEM

Also, APTA members have expressed support for proposals which enhance the usefulness of group solutions to the insurance problem. For several years, our association sponsored a group insurance program of which our agency was a member.

This was suspended last year, however, because the underwriter withdrew from the program and a replacement has not been found.

Recently, however, 15 cities in Wisconsin formed their own insurance company. They anticipate a dramatic reduction in costs, and the model is under study in several other States.

Mr. Chairman, Senator Sasser, members of the committee, we hope this information is helpful to you. We appreciate the opportunity for public transit to have its day in these hearings.

We are eager to cooperate with you and provide you with whatever information you may need.

[The complete prepared statement follows:]

Senator HECHT. Thank you very much.
Ms. RUSS.

STATEMENT OF MARYANN RUSS, EXECUTIVE DIRECTOR, WILMINGTON, DE, HOUSING AUTHORITY

Ms. RUSS. Thank you, Chairman Hecht, Senator Sasser.

My name is MaryAnn Russ. I am the executive director of the Wilmington-Delaware Housing Authority. I am testifying here on behalf of the Council of Large Public Housing Authorities [CLPHA], an organization comprising 42 PHA's that own and manage nearly 40 percent of the Nation's stock of 1.3 million conventional public housing units.

I am grateful to you for inviting CLPHA to testify today. As your committee is well aware, every single person has talked to you about this as a liability insurance crisis. Public housing authorities, of which there are approximately 3,000 throughout every State in the Nation, are being caught up in this crisis, with potentially devastating results.

We are very pleased that the Senate Commerce Committee is considering a bill, S. 2129, that would enable governmental units to participate in interstate insurance pools.

We strongly endorse this bill and would like this committee to add provisions to make this bill explicitly applicable to public housing and redevelopment authorities.

CLPHA thanks you for your recognition of the problem and your positive and timely steps to provide us with one of the remedies most urgently needed.

FORCING RETRENCHMENT OF SERVICES

This insurance crisis is striking at the heart of State and local governments throughout the country, forcing them to retrench deeply on services they provide, because liability insurance is either too expensive or cannot be obtained at all.

This is especially true for public housing. Public housing authorities are, to use a somewhat loaded term, essentially landlords, owning and operating housing which forms cities within cities.

The New York City Housing Authority owns over 170,000 units, housing half a million people. The Baltimore Housing Authority has about 22,000 units, including its section 8 rental assistance units.

We need the same kind of insurance that you buy in your own home, property insurance which covers fire and extended coverage, and general liability insurance, public housing sureties.

What we're insuring is 70 billion dollars' worth of property values, as well as providing PHA liability coverage for the over 3.5 million people who live in public housing and the thousands more each year who work in or visit public housing.

Mr. James Baugh, Deputy General Assistant Secretary of Housing for Public Housing, has recently testified before Congress that PHA's are typically experiencing increases of greater than 400 percent in their annual premiums for property coverage, and even higher increases in their premiums for liability coverage.

Still other PHA's have lost their insurance coverage altogether. Attached to my testimony are examples, but I'd like to kind of hit the highlights. You mentioned one in your own State, the Las Vegas Housing Authority, had their annual insurance premium tripled.

And at the same time, their upper limit on general liability coverage was reduced from $10 million to $1 million, with a $500,000 self-insured retention.

This PHA, as a result of what is happening to their insurance, is considering eliminating their security force entirely.

The Salt Lake City Authority experienced a major increase in the cost of its directors and officers policy. Of course, you have to buy that or soon you won't have a board.

The Philadelphia Housing Authority, the third largest in the Nation, has been totally bare on its liability coverage since November of 1985.

It can find no company at all that will carry its insurance.

The Denver Housing Authority is totally bare in liability coverage and is trying to establish a State pool. Last fall, the New York City Housing Authority sent out 50 requests for proposals for general liability coverage and got back only two proposals from the same company.

Its policy now has a $250,000 self-insured retention. In Albany, the premium for the general liability policy went from $22,000 in 1984–85 to $298,000 in 1985–86, a 1,448-percent increase.

To pay for it, the authority is laying off 21 staff members. In Albany, they fear that although the authority is currently financially sound, they may face bankruptcy within a few years if these patterns continue.

These are just a few examples, and there are more appended to my testimony. We are trying to do something about this.

INTERSTATE INSURANCE POOLS

In November 1985, the CLPHA sponsored a meeting in Chicago to address the insurance crisis. We created what we called our insurance crisis study group to explore the feasibility of setting up an interstate pool or PHA-owned captive insurance companies.

The PHA's attending the meeting were unanimous in our opinion that it was time to get off the roller coaster of the private insurance market, whose crisis nature is based upon fluctuations in interest rates, price wars among insurance companies, and other factors.

We believe we have a better chance with a stable, predictable business that could be insulated from these recurring crises in the private market, and if the PHA insurance business were pooled, it could result in more stable premium levels and perhaps slightly lower premiums.

But, mainly, we could guarantee that we could get it. We would have availability of coverage.

In March, a nationally known risk management consultant was selected by the study group to conduct a study of the feasibility of establishing a pool or a captive. We are now working on questionnaires, looking at our losses and risks, and trying to put together our data for this.

At its April 30 meeting in Cleveland, the study group noted the work of the Senate on S. 2129 and asked me to convey to you CLPHA's support for and appreciation for this bill.

They asked also that your committee specifically include or recommend to the Commerce Committee wording to name public housing authorities and redevelopment authorities as eligible to engage in interstate pooling.

We believe this may be necessary because, in most cases, PHA's are well-established under State-enabling legislation, are not considered to be general units of local government but special authorities.

So we believe the language as it's presently constituted might pose a problem for us.

What is HUD doing in response to the insurance crisis? I cannot conclude this testimony without telling you what HUD is doing about the PHA insurance crisis. In a word, nothing.

First, HUD even refuses to acknowledge that the insurance crisis exists.

Senator HECHT. Your 5 minutes are up. Please summarize in the next minute, OK?

Ms. RUSS. Certainly.

Essentially, we urge this committee to direct HUD, through letters and report language, to first recognize the insurance crisis being faced by public housing authorities; second, to fulfill its statutory responsibility to make the necessary adjustments in PHA budgets and operating subsidies; to recognize the actual internal costs that PHA's must currently pay, which are expected to total over $100 million more than HUD's current operating subsidies, and for which HUD currently has the operating subsidies available; provide adequate levels of CIAP funds to PHA's to help reduce the deteriorating and substandard conditions in aging public housing stock, since these conditions increase our property and liability insurance exposure; and, finally, to support S. 2129.

[The complete prepared statement follows:]

STATEMENT OF

DENNIS J. FITZGERALD

MEMBER, INSURANCE TASK FORCE

AMERICAN PUBLIC TRANSIT ASSOCIATION

AND

EXECUTIVE DIRECTOR, CAPITAL DISTRICT TRANSPORTATION AUTHORITY

ALBANY, NEW YORK

BEFORE THE

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

HONORABLE CHIC HECHT, CHAIRMAN

MAY 15, 1986

538 DIRKSEN SENATE OFFICE BUILDING

WASHINGTON, D.C.

GOOD MORNING, MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE. MY NAME IS DENNIS FITZGERALD. I AM EXECUTIVE DIRECTOR OF THE CAPITAL DISTRICT TRANSPORTATION AUTHORITY OF ALBANY, NEW YORK. MY TRANSIT SYSTEM CARRIES 14 MILLION PASSENGERS PER YEAR ON 240 BUSES AND EMPLOYS 475 PEOPLE. I AM A MEMBER OF THE AMERICAN PUBLIC TRANSIT ASSOCIATION'S INSURANCE LIABILITY TASK FORCE.

APTA IS AN INTERNATIONAL ORGANIZATION OF TRANSIT SYSTEMS AND RELATED ORGANIZATIONS. NINETY-FIVE PERCENT OF THOSE USING PUBLIC TRANSIT IN THE UNITED STATES ARE CARRIED BY APTA MEMBERS.

AS IS THE CASE WITH BROAD SEGMENTS OF OUR SOCIETY, MASS TRANSIT IS BEING SEVERELY AFFECTED BY A DRAMATIC INCREASE IN TORT LITIGATION. AND, LIKE MANY OTHERS, THE PUBLIC TRANSIT INDUSTRY HAS BEEN REELING FROM EXTRAORDINARILY HIGH LIABILITY INSURANCE COSTS. ACCORDING TO A SURVEY APTA CONDUCTED LAST YEAR, NEARLY 70 PERCENT OF THE RESPONDING TRANSIT SYSTEMS ENCOUNTERED SEVERE DIFFICULTY IN SECURING ADEQUATE LIABILITY COVERAGE AT RENEWAL TIME. AND FOR THE LIABILITY INSURANCE COVERAGE WHICH IS AVAILABLE, COSTS HAVE SOARED. MASS TRANSIT HAS RECENTLY EXPERIENCED RATE INCREASES FROM 200 PERCENT TO OVER 1000 PERCENT. CASUALTY/LIABILITY INSURANCE IS RAPIDLY BECOMING THE SECOND MOST COSTLY OPERATING EXPENSE AFTER LABOR.

IN MY SYSTEM IN ALBANY, NEW YORK, FOR EXAMPLE, OUR INSURANCE PREMIUM INCREASED IN ONE YEAR FROM $98,900 TO $421,500, WHILE OUR SELF-INSURED RETENTION INCREASED OVER 1000 PERCENT AND OUR CEILING FOR COVERAGE DROPPED BY $5 MILLION. AND WE ARE TOLD THAT WE CAN EXPECT AT LEAST ANOTHER 50 PERCENT INCREASE THIS YEAR.

ALL OF THIS COMES AT A TIME OF PROPOSALS TO DECREASE FEDERAL FINANCIAL SUPPORT FOR PUBLIC TRANSIT SYSTEMS. ALSO, STATE AND LOCAL BUDGETS CANNOT BE EXPECTED TO PROVIDE FOR EXTRAORDINARY INCREASES IN INSURANCE PREMIUMS. THIS INDUSTRY IS SIMPLY UNABLE TO ABSORB FURTHER COMPARABLE INCREASES IN THE COST OF LIABILITY INSURANCE AND LIABILITY-RELATED EXPENSES WITHOUT JEOPARDIZING THE VERY NATURE OF THE ACTIVITY ITSELF. IN FACT, SOME LOCAL SYSTEMS HAVE EVEN FACED THE SUSPENSION OF OPERATIONS BECAUSE OF THE LACK OF INSURANCE COVERAGE.

FURTHER, PUBLIC TRANSIT BEARS THE ADDITIONAL COSTS OF BEING PERCEIVED BY PLAINTIFFS AS HAVING UNLIMITED RESOURCES TO PAY CLAIMS - THE SO-CALLED "DEEP POCKETS" - BUT, UNLIKE OTHER GOVERNMENTAL DEFENDANTS, PUBLIC TRANSIT IS FREQUENTLY NOT COVERED BY STATE IMMUNITY NOR TORT CLAIMS PROVISIONS. PUBLIC TRANSIT TYPICALLY FACES THE SAME LIABILITY EXPOSURE AS PRIVATE CORPORATIONS DO, BUT IS INCREASINGLY WITHOUT THE RESOURCES TO PAY FOR ADEQUATE INSURANCE COVERAGE OF LIABILITY RISKS. THEREFORE, WHERE REFORM EFFORTS ARE DIRECTED AT THE CONTINUATION OF ESSENTIAL GOVERNMENTAL SERVICES THROUGH IMMUNITY OR TORT CLAIMS PROVISIONS EITHER AT THE STATE OR THE FEDERAL LEVEL IT IS IMPORTANT THAT PUBLIC TRANSIT BE INCLUDED IN SUCH PROVISIONS.

APTA MEMBERS HAVE EXPRESSED SUPPORT FOR EFFORTS WHICH ARE BEING DIRECTED AT THE STATE AND THE FEDERAL LEVEL AT TORT LAW REFORM. APTA'S INSURANCE LIABILITY TASK FORCE, WHICH WAS FORMED SPECIFICALLY TO DEAL WITH PUBLIC TRANSIT'S INSURANCE CRISIS, HAS IDENTIFIED TORT LAW REFORM AS A PRIORITY AREA OF CONCERN. APTA IS MONITORING STATE AND FEDERAL DEVELOPMENTS IN THIS AREA SO THAT OUR MEMBERS ARE POISED TO PARTICIPATE IN THOSE EFFORTS WHICH ARE LIKELY TO MAKE A CONTRIBUTION TO LOWERING THE COSTS ASSOCIATED WITH LIABILITY RISKS. FOR EXAMPLE, THE COMPREHENSIVE TORT REFORM LAW RECENTLY ENACTED IN THE STATE OF WASHINGTON WAS SUPPORTED BY TRANSIT SYSTEMS IN THE STATE.

FURTHERMORE, APTA MEMBERS HAVE EXPRESSED SUPPORT FOR THE EFFORTS PRESENTLY UNDERWAY TO DEAL WITH TORT LAW REFORM FROM A BROAD PERSPECTIVE, RATHER THAN ON AN INDUSTRY-BY-INDUSTRY BASIS. IT IS IMPORTANT THAT ALL SEGMENTS OF OUR SOCIETY BENEFIT FROM EFFORTS UNDERTAKEN TO REFORM OUR CIVIL JUSTICE SYSTEM AND THAT WE NOT RUSH TO SOLVE ONLY SPECIFIC TORT LIABILITY PROBLEMS.

ALSO, APTA MEMBERS HAVE EXPRESSED SUPPORT FOR PROPOSALS WHICH ENHANCE THE USEFULNESS OF GROUP SOLUTIONS TO THE INSURANCE PROBLEM. FOR SEVERAL YEARS APTA SPONSORED A GROUP INSURANCE PROGRAM. THIS WAS SUSPENDED LAST YEAR BECAUSE THE UNDERWRITER WITHDREW FROM THE PROGRAM AND A REPLACEMENT HAS NOT BEEN FOUND.

RECENTLY, HOWEVER, 15 CITIES FORMED A TRANSIT ASSOCIATION CAPTIVE INSURANCE COMPANY IN WISCONSIN. THEY ANTICIPATE A DRAMATIC REDUCTION IN INSURANCE COSTS, AND THE MODEL IS UNDER STUDY IN SEVERAL OTHER STATES. EFFORTS DIRECTED AT FACILITATING SUCH MARKET SOLUTIONS TO THE INSURANCE CRISIS ARE LIKELY TO PROVIDE AN IMMEDIATE BENEFIT TO THOSE HAVING TO COPE DAY-TO-DAY WITH THE NEED TO PROVIDE COVERAGE FOR LIABILITY RISKS.

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, WE HOPE THIS INFORMATION IS HELPFUL TO YOU. WE APPRECIATE THE OPPORTUNITY TO BRING TO YOUR ATTENTION THE VIEWS OF THE PUBLIC TRANSIT INDUSTRY. WE ARE EAGER TO WORK WITH THE SUBCOMMITTEE OR APPROPRIATE GOVERNMENT AGENCIES TO FIND A LASTING SOLUTION TO WHAT IS EXPECTED TO BE A SIGNIFICANT PROBLEM TO THE TRANSIT INDUSTRY FOR SOME TIME.

STATEMENT OF
MARY ANN RUSS
EXECUTIVE DIRECTOR
HOUSING AUTHORITY OF WILMINGTON, DELAWARE
ON BEHALF OF THE
COUNCIL OF LARGE PUBLIC HOUSING AUTHORITIES,

ON THE
INSURANCE CRISIS IN PUBLIC HOUSING

BEFORE THE
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
OF THE
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

MAY 15, 1986

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1. Introduction.

Mr. Chairman, members of the Committee, Committee staff, and other witnesses, my name is Mary Ann Russ and I am the Executive Director of the Wilmington (Delaware) Housing Authority. I am testifying here on behalf of the Council of Large Public Housing Authorities (CLPHA), an organization comprising 42 PHAs that own and manage nearly 40 percent of the nation's stock of 1.3 million conventional public housing units. Our PHAs also administer approximately 150,000 units of rental assistance (Section 8 "existing" and "mod. rehab.") going to households living in the private housing stock.

I am very grateful to you for inviting CLPHA to testify before you today. As your Committee is well aware, there is a national crisis in liability insurance. Public Housing Authorities, of which there are approximately 3,000 throughout every state in the nation, are being caught up in this crisis with potentially devastating results. We are pleased that your Committee is considering a Bill, S.2129, that would enable governmental units to participate in interstate insurance pools. We strongly endorse this Bill, and would like the Committee to add provisions to make the Bill explicitly applicable to public housing and redevelopment authorities. CLPHA thanks you for your recognition of the problem and your positive and timely steps to provide us with one of the remedies most urgently needed.

Mr. Chairman, the insurance crisis is striking at the heart of state and local governments throughout the country, forcing them to retrench deeply on services they provide, because liability insurance is either too expensive or cannot be obtained at all. This is especially true for public housing. Public Housing Authorities are --

to use a somewhat loaded term -- essentially landlords, owning and operating housing which forms "cities within cities" in their own communities. The New York City Housing Authority owns over 170,000 units housing half a million people. The Baltimore Housing Authority has about 22,000 units, including its Section 8 rental assistance units. You know what kinds of insurance you need on your own homes: a) fire and extended (property) coverage; and b) general liability. Public Housing Authorities require the same kinds of insurance to protect the approximately $70 billion in property values in the existing public housing stock, as well as to provide PHA liability coverage relating to the over 3.5 million people who live in public housing and thousands more each year who work in or visit public housing, its premises, and its offices.

2. The Current Crisis in Public Housing Insurance Coverage.

Mr. Chairman, since January 1985 a full-blown crisis has developed in public housing liability and property insurance coverages. Mr. James Baugh, General Deputy Asst. Secretary at HUD for Public Housing, has recently testified before Congress that PHAs are now typically experiencing increases of +400% in their annual premiums for property coverage, and even higher increases in their premiums for liability coverage. Still other PHAs have lost their insurance coverage altogether. Attached to this testimony (Attachment A) are the results of a telephone survey CLPHA took last week, including at least one PHA from the state of each member of this Committee, showing recent PHA experience with liability insurance.

For example, the annual insurance premium for the Las Vegas Housing Authority was recently tripled while its upper limit of G.L. coverage was reduced from $10 million to $1 million, with a $500,000 self-insured retention. This PHA is now considering eliminating its security force entirely. The Salt Lake City Authority experienced a major increase in the cost of its Directors and Officers (public liability) policy. The Philadelphia Housing Authority, third largest in the nation, has been totally "bare" on its liability coverage since November 1985; it can find no company that will carry its insurance. The Denver Housing Authority is totally bare on liability coverage and is seeking to establish a state pool with other Colorado PHAs. Last fall the New York City Housing Authority sent out 50 Requests for Proposals for its G.L. coverage, and got back only two proposals (from the same company). Its policy now has a $250,000 self-insured retention. In Albany, the premium for the G.L. policy went from $22,000 in 1984-85 to $298,000 in 1985-86, a +1448% increase! In order to pay for this, the Authority is laying off 21 staff; and it fears that although the Authority is currently financially sound, it may face bankruptcy within a few years if these patterns continue. In Atlanta, the premium for the G.L. policy in 1984-85 was $732,000, up from $80,000 in the previous year! The Houston Authority is currently bare on its fire and extended coverage. Detroit sent out 35 RFPs and got two bids on its G.L., and ended up paying twice the premium this year as last. Baltimore had its G.L. policy cancelled in February 1986 and since then has "gone bare." It had recently received bids at over 10 times the previous premium levels. In one example of a pending liability case in Baltimore, a child climbing a tree touched a high-tension wire with his foot. The family originally sued for $26 million, and current negotiations are in the range of $3 million. In Attachment A, there is also information on Milwaukee, San Francisco, Sacramento, New Haven, the New England Master Policy, Chicago, Nashville, and Wilmington.

3. PHA Action in Response to the Insurance Crisis.

Mr. Chairman, our PHA staffs are spending an enormous amount of time exploring all possible avenues for obtaining coverage in the private sector. However, as these efforts have become increasingly frustrating and often fruitless we have been forced to consider other alternatives.

In November 1985, CLPHA sponsored a meeting in Chicago to address the insurance crisis. Out of that meeting, CLPHA established a public housing Insurance Crisis Study Group (ICSG), with the purpose of exploring the feasibility of setting up an interstate pool or PHA-owned "captive" insurance company. The PHAs attending the meeting were virtually unanimous in their opinion that it was time to get off the roller-coaster of the private insurance market -- whose crisis nature is based upon fluctuations in interest rates, price wars among insurance companies, and other factors. PHAs believe they have a stable, predictable business that could be insulated from these recurring crises in the private insurance market -- and that if the PHA insurance business were pooled it could result in more stable premium levels and also possibly slightly lower premiums, as well as guarantee the availability of such coverage.

The Insurance Crisis Study Group (ICSG), under the Chairmanship of George James, Executive Director of the Cuyahoga Metro. (Cleveland) Housing Authority, has continued to meet since November 1985. In March, a nationally known risk management consultant was selected to conduct a study of the feasibility of establishing a pool or a captive. Insurance questionnaires are being sent to PHAs across the country as the first step in this study; and the study is expected to be completed by August 1986. At its April 30 meeting in Cleveland, the ICSG noted the work on S.2129, and asked me to convey to you CLPHA's support for, and appreciation of, this Bill. The ICSG also asked that your Committee specifically urge wording in the Bill to name public housing authorities and redevelopment authorities as eligible to engage in interstate pooling. We believe this may be necessary because in most cases PHAs, while established under state enabling legislation, are not considered to be general units of local government but special authorities. We would also like to see property coverage (fire and extended coverage) explicitly included in the Bill, and, if possible, its sunset provision eliminated. We will also certainly be available to help the Committee in redrafting the Bill so that PHA concerns are fully addressed.

4. What is HUD doing in response to the PHA insurance crisis?

Mr. Chairman, I cannot conclude this testimony without telling you what HUD is doing about the PHA insurance crisis. In a single word, "nothing." First, HUD refuses even to acknowledge that the insurance crisis exists. A recent letter which CLPHA received from James Baugh of HUD (Attachment B) states that a survey HUD conducted of 407 PHAs in 1985 did not support the idea that a crisis exists in the property/casualty market, and that HUD has therefore withdrawn a request for legislation that would have permitted HUD to form a self insurance fund. Based upon our own experience with PHAs, we cannot understand how HUD can fail to acknowledge the crisis. Second, PHAs across the country have been asking their HUD field offices for budget adjustments to recognize higher insurance costs -- and to increase the federal operating subsidy accordingly. HUD has rejected all such requests for subsidy adjustments even though there are operating subsidy funds available at the national level to make such adjustments and a valid regulatory mechanism for doing so. The statute establishing the funding system for public housing operating subsidies directs HUD to recognize the PHAs' actual costs in establishing operating subsidy levels, and HUD's refusal to do so, we believe, violates this statute. Third, even though HUD says it sees no insurance crisis for PHAs, HUD has been telling PHAs that cannot obtain coverage that they should simply "go bare" on their insurance coverage. The Annual Contributions Contract (ACC) under which PHAs receive operating subsidies from HUD specifies that PHAs must have insurance coverages such as property, comprehensive general liability, public officials' liability, automobile insurance, etc. Washing its hands, however, HUD has now signed waivers of these ACC requirements for over 65 PHAs -- including in some cases liability coverage, in some property, and in some both. Applications are pending from nearly 20 more. A list of these Authorities is attached as Appendix C. Mr Chairman, we are terrified at what could happen to the PHAs in the future under these circumstances. Last year, CLPHA met with then-Asst.

Sec. for Public Housing, Warren T. Lindquist and asked what HUD would do to help a PHA that "went bare" on its insurance coverage at HUD's direction and was then struck with a large settlement against it, perhaps in the millions of dollars. Mr. Lindquist stated that HUD would never stand idly by and allow a PHA to face bankruptcy. HUD would find some way of helping the Authority. Today, Mr. Lindquist is no longer at HUD, and neither is that policy. Instead, HUD staff says that HUD's General Counsel has issued an internal, informal opinion that in such a disaster for a local PHA, HUD has no legal responsibility to help out, and probably should not do so lest HUD responsibility be inferred. This hands-off, do-nothing approach by HUD has recently been interpreted by one Regional Office as meaning that HUD should even tell a PHA to ignore a court awarded judgement (see Attachment D). We think that it is inevitable that in the near future a disaster is bound to occur -- a financial disaster for a growing number of Housing Authorities across the United States. As that disaster begins to spread, PHA Board Members will find their names in the headlines for having approved their PHAs' going bare on insurance, resulting in financial disaster, as will HUD officials who have signed off on the waivers of the ACC requirements.

Mr. Chairman and members of the Committee, we thank you for this Committee's support for the public housing modernization (CIAP) program in the past. Because of this program, we are able to reduce may of the conditions in public housing which could result in insurance exposures and financial losses to the public housing authorities, and we urge you to continue your support for CIAP in the future. In addition, we urge the Committee to direct HUD, through letters and report language, to:

a) recognize the insurance crisis being faced by Public Housing Authorities across the country;

b) fulfill its statutory responsibilities to make the necessary adjustments to PHA budgets and operating subsidies to recognize the actual insurance costs that PHAs must currently pay, which are expected to total over $100 million more than HUD's current FY87 operating subsidy estimates; and,

c) provide adequate levels of CIAP (modernization) funds to PHAs to help reduce deteriorating and substandard conditions in aging public housing, since such conditions increase our property and liability insurance exposures.

Thank you, Mr. Chairman, for your attention and the opportunity to testify before you today. I would be glad to try to answer any questions you may have.

Attachments:

A - General Liability Insurance Problems of Selected Housing Authorities as of May 9, 1986: Las Vegas, Salt Lake City, Philadelphia, Pittsburgh, Denver, New York City, Albany, Seattle, Atlanta, Houston, Detroit, Baltimore, Milwaukee, San Francisco, Sacramento, New Haven, New England Master Policy, Chicago, Nashville and Wilmington.

B - Letter to CLPHA from HUD dated May 1, 1986.

C - List of PHAs that have been granted waivers of ACC requirements by HUD for property or liability coverages. (As of 5/2/86.)

D - Insurance problems of the Jersey City PHA, and failure of HUD to provide backing to the PHA (5/2/86)

E - Court descision in New York City liability suit against the Housing Authority.

ATTACHMENT A

CLPHA

Council of Large Public Housing Authorities

Akron
Anchorage
Baltimore
Boston
Brookline
Buffalo
Cambridge
Chicago
Cincinnati
Cleveland
Columbus
Greensboro
Harrisburg
Houston
Jersey City
Las Vegas
Louisville
Mansfield
Milwaukee
Minneapolis
Mobile
Montgomery Cnty
New Bedford
New Haven
New York
Newark
Oklahoma City
Omaha
Philadelphia
Pittsburg
Portland
Providence
Rochester
Sacramento
St Louis
St Paul
St Petersburg
San Francisco
Seattle
Toledo
Washington
Wilmington

ATTACHMENT A - General Liability Insurance Problems of Specific Housing Authorities - May 9, 1986

1. Las Vegas, Nevada. The Authority has had major insurance problems during the past year. Their premium increased from $50,000/yr. in 1984-85 to $160,000/yr. in 1985-86 for a package that includes both G.L. insurance and property insurance. At the same time, their G.L. limits were drastically reduced from $10 million down to $1 million, with a $500,000 self-insured retention; so they now have no umbrella liability coverage over $1 million.

The loss of coverage hurts more than the premium increase. They believe that at least some of the problem is due to unreasonable court awards in previous cases, e.g. in a case where the PHA's security guards called the police on someone they suspected of drug dealing, but the charges had to be dropped due to insufficient evidence.

Most of the PHA's units comprise housing for the elderly.

The PHA is now considering eliminating its security force as a result of potential lawsuits against it. They might consider pulling back from all security responsibilities and adopting a policy that security is strictly the responsibility of the local police department.

2. Salt Lake City, Utah. The Authority has not had a serious problem with G.L. insurance, but has had a major problem with public liability insurance (e.g. errors & omissions) for their staff, Exec. Dir. and Commissioners. Last year the PHA went out to bid on the public liability policy, and the lowest bid they received was for approximately $6,000. They thought this was much too high, so they tabled the issue. This year, they went back into the market, and the same companies are now out of the market entirely. They eventually received a bid of just over $11,000 for the same coverage, and had to accept it in order to protect themselves, for example in the case of discrimination or negligence suits. They have about 1700 federal units.

3. Philadelphia, Pennsylvania. The Philadelphia Housing Authority has been "bare" since November 1985 on comprehensive general liability, because their original insurance company claims it lost its reinsurance treaty. Their G.L. policy had been running about $1 million per year in premiums. The only reason given was that their re-insurer no longer had the capacity. Their Directors and Officers policy has been cancelled twice. The first time, the company went bankrupt; the second time, the company lost its reinsurance, so this policy was cancelled 9/21/85. No one else will place their insurance. They have tried placing it through

the Pennsylvania Insurance Department and numerous brokers and agents, but to no avail.

They have no way to estimate at this time what their financial requirements are going to be, as a result of their going bare. They have received a 6-month waiver of the ACC requirements from HUD, and will probably then have to apply for another waiver.

"No one is giving us insurance."

4. Pittsburgh, Pennsylvania. This PHA currently has G.L. insurance, but it's due to expire 7/9/86, so they're now out looking for bids, and should know what the results will be by May 22. Between their 84-85 and 85-86 insurance years, premiums jumped from $75,000 annually with zero deductibles to a current rate of $250,000 premium, including a $10,000 deductible per occurrence. They now have a $500,000 upper limit of liability.

The PHA had Directors and Officers coverage through 11/85, at a premium of $10,000 per year, but were cancelled at that time. They went out looking for coverage, but only got one bid, from Lloyd's of London, for $140,000/year, so they didn't renew and are now bare.

As a result of increases in premiums for the G.L. and property coverages, their total insurance costs for all types of coverage have increased by 60-70% in a single year -- accompanied by reductions in coverage and increases in deductibles. (They've never had deductibles before.)

The PHA is financially sound, but the above major increases in insurance costs are one of the reasons why, in union negotiations now, the PHA has offered no salary increases this year.

The PHA has about 10,000 units of housing.

5. Denver, Colorado. At the present time, the Denver Housing Authority is totally "bare" (self-insured) on General Liability. They've requested a waiver of ACC requirements from HUD, but haven't yet received it. They had a four-year policy, but it was cancelled on February 15 after only one year. They went out for formal bids, and also dealt with 3 brokers, but nobody could come up with anything. They have about 4500 units. They are very worried about what would happen if they had a big claim. They're trying to get together with other Colorado PHAs to form a state pool. They did get an initial bid from one company for $100/unit/year for their G.L. policy alone, but this never came through.

6. New York City. The NYCHA's 84-85 G.L. policy expired 9/1/85. At that time, they went out for bid, and sent out 50 Requests for Proposals (RFPs). They got back two proposals from the same company. The first proposal was to provide $750,000 coverage with a $250,000 self-insured retention, at a premium of $3.8 million. The second proposal would provide $900,000 coverage, with a $100,000 self-insured retention, at a premium of $5 million. Neither included professional liability coverage, tenant program coverage, day camps or coverage of their community centers. They accepted the $3.8 million policy.

Since September 1, 1985, the NYCHA has been trying to obtain insurance coverage for professional liability, tenant programs, day camps and community centers, without success. [There is limited coverage for community centers in their current G.L. policy.]

The NYCHA is currently totally without public officials insurance. They're working to get it, but say the usual sources have mostly dried up.

The NYCHA thinks it needs as much as $51 million in umbrella liability coverage. After September 1985, they continued to search for additional layers of coverage over their first $1 million. In January 1986, they obtained an additional layer of coverage up to $6 million, for a premium of $3.3 million. [The new layer = $5 million in coverage.] Their total costs for the $6 million in coverage therefore now equals $7.1 million annually, an "astronomical" increase from their previous G.L. costs for a much higher level of coverage.

The NYCHA has shown this increase in the budgets submitted to HUD, and HUD has approved the increases. However, the NYCHA's operating subsidy has not been increased accordingly. Instead, the increased insurance costs have to be taken out of some other area of the Authority's operations.

Two of the areas where the NYCHA has a significant number of liability suits each year are: a) slipping and falling on interior stairwells; and b) rapes. (See Attachment E for a recent related court decision.)

7. Albany, N.Y. The premium for their G.L. policy went from $22,000 for FY84-85 to $298,000 for FY85-86 (starting 9/85), a +1448% increase. They had to change companies, and their limits decreased from $1 million to $250,000. They have about 1765 units.

The cost of their automobile insurance went up 50% on liability.

They're not sure about the fire insurance yet. They have a 3-year policy. The first year was $35,000; the second year $41,000; they haven't received the invoice for the third year yet -- which was due 4/1 -- and their agent says the premium is likely to be about $128,000.

The increased insurance costs have to come out of their operating budget. Primarily because of such increases, the Albany Housing Authority has recently laid off 21 people out of a staff of 122, so they're back to about 101 now. This is approximately an 18% cut in staff.

Albany was part of the New York State Master Policy until September 1985. Under that policy, they paid $22,000 per year for G.L. insurance. Now, their insurance cost per unit month (PUM) has risen from $12 under the old policy to $169. They feel fortunate that they obtained coverage at all. They pointed out that after the New York State master policy was cancelled, some New York State PHAs obtained coverage from the Great Global Insurance company, which since has gone bankrupt.

The Albany authority feels that it will have to dip into its reserves annually to meet future insurance costs, and that they will go bankrupt before long if HUD fails to make the necessary adjustments to PHA budgets and operating subsidies.

8. Seattle, Wash. The Seattle Authority has no serious problems with their G.L. insurance policy at the present time. They will be renegotiating their policy in October 1986.

9. Atlanta, Georgia. The Atlanta Housing Authority has experienced major insurance problems during the past year. For 84-85, their liability premium was $732,000 per year, up from $80,000 in the previous year. For 85-86, they have reduced coverage, and a liability premium of $685,000 per year, down by about $47,000. Reason given for the increased cost was "the current crisis in the industry." Liability coverage is currently $1 million, with a $25,000 deductible. They may consider self-funding in the future, but they wanted to stay covered in the interim. They do currently have D&O coverage, at a reasonable rate, through Fred S. James of Boston, with re-insurance provided by Lloyd's of London.

10. Houston, Texas. The Houston Housing Authority has had no problems maintaining their General Liability coverage, with only an 8% increase in premiums this year. The Authority credits their aggressive marketing campaign for this result. They are currently "bare" on fire and extended coverage, however, and have obtained waivers from HUD. They cannot obtain this coverage anywhere at a reasonable cost.

11. Detroit, Michigan. The PHA had a great deal of trouble getting G.L. coverage this year. They sent out 35 RFPs and only got two bids. They accepted the low bid, but the price was nearly doubled from last year, along with lower limits of liability. They're having great difficulties finding companies to bid. They just got their fire insurance renewed in January, and it now costs $1.3 million per year, as opposed to$400,000 last year. Their policy year expires 6/30 for their G.L. The Housing Authority is in very difficult shape financially, and has virtually no reserves. They expect to get hit hard with additional premium increases or losses of coverage after 6/30/86. They have an above average vacancy rate, and HUD is trying to force the Authority to implement vacancy-reduction plans, at the same time that the staff available to do the work will have to be cut down, in part due to escalating insurance costs.

12. Baltimore, Maryland. They had a G.L. policy beginning 7/1/85, at an annual premium of $138,733, with a limit of liability of $500,000. Premium was considered artificially low because of pressure from the State Insurance Commission. In October they were notified that the insurance company was "cancelling that line of coverage." They then appealed to the state insurance commission, which maintained their coverage until February 1986, but since February they have been "bare" on liability insurance. They also have no "excess" coverage, which previously had been up to $1 million, or "umbrella" coverage, which previously had been up to $2 million.

They are trying to get replacements for their primary as well as excess and umbrella coverage. They recently received two proposals for replacement of their primary coverage; each proposal had a premium of about $2 million (as opposed to $138,733 for their previous policy). They didn't accept either proposal.

They have 22,000 units, including Section 8 units. For the latter, they do have some responsibility because of the need for the PHA to inspect for hazards such as asbestos, lead paint, etc.

One example of a liability case they currently have is where a child climbing a tree touched a high-tension wire with his foot. The family sued for $26 million, and they're currently negotiating in the area of $3 million.

They have no Directors and Officers insurance, and no professional liability for staff.

They have approached HUD for a subsidy adjustment, but have been turned down.

They don't expect to be able to obtain G.L. coverage again at reasonable rates for 3-4 years.

The Authority has generally been in good shape financially, and hasn't been financially troubled. It could happen, however, if they get hit with a couple of large lawsuits.

The State Legislature is currently considering putting a limit on personal damages awards.

13. Milwaukee, Wisconsin. The Milwaukee Authority's current policy for G.L. expires 6/15/86. Last week, after sending out approximately 28 RFPs, they received one bid. This was for primary coverage only, not for excess liability. The bid was for $170,000, for exactly the same coverage as last year, which cost $65,000. The limit of liability is $500,000. Staff consider it probable that the Commissioners will accept the bid.

14. San Francisco, California. They have obtained coverage, but with huge price increases. Insurance costs have increased by about $600,000 in a single year (including G.L. and property). They are currently paying $300,000 per year on G.L. alone, with a limit of $300,000 per occurrence. Commissioners have considered "going bare," but instead decided to pay the higher costs. They couldn't obtain auto insurance, so they were put into the state risk pool, without collision coverage. The escalating insurance costs are one reason the San Francisco Authority has suffered from a 10% decrease in employees during the past year, with many other cuts in their operating budget. They expect this major impact to continue in future years unless something is done about insurance costs and availability.

15. Sacramento, California. Last year they paid $168,000 for primary coverage of $500,000 and excess coverage to $6 million. This year they're having to pay $453,613 for primary coverage of $500,000, and no excess or umbrella coverage. Last year, their premium for property/fire premium was $280,000; this year it's been quoted at $520,000. They feel they're being priced out of the market; plus, they've been completely unable to obtain coverage at layers over $500,000. They feel they have a very good loss record. They have obtained both types of coverage from the Fireman's Fund for the last 41 straight years. They feel they are probably one of the last PHAs in California with comprehensive general liability insurance coverage. They are currently looking at the following options:

a) going completely self-insured on both types of coverage;

b) going self-insured onthe first $1 million of comp. G.L., and trying to obtain excess coverage beyond that; or,

c) pooling with the city or county agency.

They do not believe they would profit from pooling with much larger PHAs. They believe their own housing stock is different, better maintained, etc., and don't want to assume what they think are probably the higher risks associated with the very large PHAs.

16. New Haven, Conn. The New Haven Authority obtains their G.L. coverage under a Master Policy for G.L. in New England which has been set up by HUD. Their costs under this policy have gone up considerably over the past two years, but probably not nearly as much as PHAs in other parts of the country. They have $1 million coverage, at a cost of $120,000 per year. [Also see #17.]

17. New England Master Policy. The present New England Master Policy for G.L. expires 6/1/86. HUD has now completed negotiations for a one-year extension of this policy, with the same broker and same company, with a 50% increase in premiums. The policy limits will be the same. The average per unit cost per year will be about $45, up from $30 previously. The HUD Regional Office says it considers this to be an extremely favorable rate, since it has received information from HUD Central that typical new G.L. rates for PHAs negotiating their policies are currently from $150 to $220 per unit per year.

18. Chicago, Illinois. In about April 1983, the Chicago Housing Authority went into the marketplace and purchased a three-year policy, with rates to be adjusted annually. When the first annual period ended, they continued the policy with the same conditions and the same premium. However, on the second anniversary, 4/1/85, the company more than tripled the self-insured retention from $150,000 each occurrence to $500,000 each occurrence, and also tripled the premium from $125,000/year to $375,000/ year. Then, on top of it all, the company cancelled the policy altogether as of 5/31/85. The Housing Authority went out to market, got no bids, and is now bare on G.L.

They have approached the State of Illinois Marketing Assistance Program (MAP), but may be turned down.

19. Nashville, Tennessee. The Nashville Housing Authority has no serious problems with their General Liability insurance policy. They accepted a good bid for a three-year policy in October 1984.

20. Wilmington, Delaware. The Comprehensive General Liability policy was cancelled on January 16, 1986. The Housing Authority went out for bids and received none. Recently, the Authority accepted a quotation for Comp. G.L. coverage with a $500,000 limit to insure risks involving Premises & Operations, Products and Completed Operations and Independent Contractors. The quotation excluded the Board from coverage, which would have included Personal Injury and Contractual Liability. The Authority, therefore, has requested a partial waiver from HUD since these coverage parts are required and the Authority will self-fund these risks.

ATTACHMENT B

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

OFFICE OF THE ASSISTANT SECRETARY
FOR PUBLIC AND INDIAN HOUSING

MAY 1

Mr. Robert E. McKay, Executive Director
Council of Large Public Housing Authorities
Seven Marshall Street
Boston, Massachusetts 02108

Dear Mr. McKay:

Thank you for your letter of January 24, 1986 regarding the property/casualty insurance survey of Public Housing Agencies (PHAs) completed by the Department in October 1985. I would like to comment on the various concerns addressed in your letter.

The survey of 407 PHAs was completed as part of an effort to support a FY 1987 legislative proposal which included provisions for the establishment of a national self-insurance fund for PHAs. It was our opinion that the survey would prove our contention that there is a definite crisis in the property/casualty insurance market. Unfortunately, the survey did not support our opinion. A majority of the PHA's surveyed had renewed their coverages in 1985 (as of September) and the renewal premium showed little or no increase over the premium paid by the PHA in 1984, thereby offsetting the very high increases paid by a smaller number of PHAs.

The survey focused on premiums paid and there was no equitable way to evaluate the large increases in deductibles and retention levels. The PHAs that were unable to secure coverage in 1985 had no premium expense and were not included it the final printout of the survey.

We asked each PHA to give us their "best effort" in reporting information. They reported only the data available from their files or from information that could be obtained quickly from their broker and/or insurance company. Information was reported on a "calendar" year basis. The 1985 information covered only the first nine months of the year, therefore, the loss ratio was understated since the premiums shown were not fully earned. We could not calculate the understated amount.

The following is in response to your requests as listed on page 2 of your letter:

1. The only "official" comments made by the program office were made during meetings with CLPHA, NAHRO and PHAs. We have no control over "unofficial" comments made by others.

Senator HECHT. Thank you.

Mr. Nelson, before you continue, we have some time constraints with the members.

Senator D'Amato has about 1 minute. I have submitted his statement, and he has something else to say.

Senator SASSER. Mr. Chairman, would you yield just for 1 minute and let me ask unanimous consent to submit some questions for the record?

Senator HECHT. Of course, Senator.

Senator D'AMATO. Mr. Chairman, let me first of all welcome Mr. Fitzgerald here as a distinguished panelist. Mr. Fitzgerald does a great job as the executive director of our Capitol District Transit Authority in the Albany region.

He will be testifying as to the incredible problems that escalating liability insurance premiums are placing on the transit industry in particular.

I think, Mr. Chairman, we owe you a debt of gratitude for focusing on this crisis that America faces; a crisis that affects every sector of America. The magnitude of the insurance crisis is made clear when we look at the fact that in 1985 Americans paid $9.1 billion in liability insurance, a 60-percent increase over what we paid in 1983.

These figures continue to escalate, making it impossible for people to conduct business, creating disruptions in not only the area of transportation but forcing cutbacks in school districts, day care centers, municipal operations, and within the private sector.

We simply cannot allow this situation to continue.

Let me say this, Mr. Chairman. While there may be many diverging opinions with respect to specific resolutions of the insurance crisis, we shouldn't let these disagreements deter us from our efforts to arrive at a coherent agenda for resolving this crisis.

Insurance needs must be met reasonably and affordably. So, Mr. Chairman, I commend you today for calling these hearings giving us the opportunity to listen to our distinguished panelists and hopefully come up with some reasonable proposals to deal with what is a deepening and mounting crisis.

Mr. Chairman, I do have three other hearings taking place at the same time, so I am not going to be able to stay to ask Mr. Fitzgerald some questions. But I know that he has pointed out the problems that exist in New York and the Albany area in particular.

Thank you, Senator.

Senator HECHT. As you know, Senator, we traveled to New York with the staff, and I feel I have a better understanding now after going to New York.

Senator D'AMATO. Thank you.

Senator HECHT. Thank you very much.

Senator Dodd, do you have a statement?

STATEMENT OF SENATOR DODD

Senator DODD. Mr. Chairman, I am pleased that you have arranged for these hearings on a topic that affects all Americans—the availability and affordability of liability insurance. As you know, this is a problem not only with respect to the groups before us today but with respect to all kinds of liability insurance—from products to medical malpractice to directors and officers and day care centers.

The problem is easy to see. What is more difficult to find is a solution. Any satisfactory solution must hold forth the promise of a system that will encourage safe conduct by all parties and one that will provide prompt and appropriate compensation for people injured through no fault of their own. I suggest these parameters for an answer because there is no evidence to suggest that the insurance industry, over time, does anything more than pass along the costs of the underlying system of resolving disputes over injuries.

Up until about a year ago, most of the debate surrounding this issue was focused on product liability and the proposed solution called for changing the tort standards for liability through the legal system. Not only was that approach unsuccessful politically, but it really held out little hope for improvement given that it would have continued to use the legal system to adjudicate disputes and that sympathetic judges and juries could pervert any legal standards if they wished to compensate an injured person.

That is why Senator Danforth, Senator Gorton, and I have tried to devise a system that encourages resolution of these disputes outside the legal system with people being paid for their net economic losses—and pain and suffering in serious and permanent injury cases only.

Just this week Senator Danforth and I introduced a revised approach to this problem that we hope will bring consumers and businesses together, leaving the only dissatisfied party as the attorneys. I will describe the proposal briefly and would hope that during the question and answer period each of you would give me your view as to whether such a system might also be applicable to your problems.

The approach is pretty simple. A person injured by a product could choose to file a claim with the manufacturer indicating how he or she was injured and submitting a claim for net economic losses; that is, their actual out-of-pocket expenses after subtracting compensation from private and public insurance. If the case involved a death or a serious and permanent injury, the claimant could also seek up to $250,000 for noneconomic losses. If the manufacturer agrees to pay net economic loss, any pain and suffering, and reasonable attorneys' fees, then the case would be resolved—any dispute as to the appropriate amounts would be settled through arbitration.

Similarly, a claimant could choose to file a lawsuit and then the manufacturer could offer to pay the same amounts. If the claimant turned down the offer, then the manufacturer would benefit in the subsequent lawsuit in the following ways: Any recovery would be reduced by any other sources of compensation the claimant had, pain and suffering damages could not exceed $250,000 and any joint liability would be restricted to compensation for net economic losses.

While there would be some changes in the tort system, for the most part State tort law would be left alone.

I look forward to getting your views as to whether such a system might work to solve some of your problems as well.

Senator HECHT. Mr. Nelson, would you continue?

STATEMENT OF RICHARD Y. NELSON, JR., DEPUTY EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF HOUSING REDEVELOPMENT OFFICIALS

Mr. NELSON. Thank you, Mr. Senator, members of the subcommittee.

I am Richard Nelson, deputy executive director and legislative counsel of NAHRO.

I come before you today to discuss the liability crisis as it is impacting our members and to offer some suggestions for dealing with this crisis.

Since most of the data we have collected to date relates to public housing programs, that will be the focus of my testimony.

This should not be interpreted, however, as meaning that the problem is not as severe when dealing with community development block grant programs or other assisted housing which are experiencing grave difficulties in securing affordable liability insurance coverage.

ADMINISTRATION POSITION

The crisis affects all of the agencies administering the HUD-assisted programs. It is my intent to point out the severity and significance of the problems to our agencies.

Unfortunately, the administration is taking the position that the insurance problem is not severe and, as a result, does not require intervention by HUD.

I appear before you today to tell you that this assessment of the severity of the problem is wrong. We are truly facing a crisis.

NAHRO formed a subsidiary corporation, the Housing and Development Insurance Group, to develop a national program of insurance for housing and community development agencies. The insurance group contracted with an insurance consultant to explore options and make recommendations on the most appropriate solution for the insurance problems facing these local agencies.

Our studies have shown that individual PHA's in the liability area are experiencing premium increases averaging 400 to 500 percent. Deductibles have also increased. The combination of these major premium increases and significantly increased deductibles have proven fiscally disastrous to many PHA's.

From 1984-85, the average premium increase in liability alone was almost $14 per dwelling unit, from $10.43 to $24.08. While this increase is significant in and of itself, it should be noted that the figure would be higher except for the fact that many agencies are in the middle of extended term contracts with no premium increases and a significant number of agencies have no coverage and therefore are not factored into these 1985 costs.

HUD has authorized some 84 public housing authorities to go without insurance because of its unavailability or unavailability at reasonable cost.

While a number of very large housing authorities are included, the 84 agencies include a variety of different sized PHA's.

Also, this number reflects only those that have as of this date reported to HUD their inability to get insurance.

COST TO PHA'S WAS $139 MILLION

HUD has estimated that the actual cost of insurance for PHA's during 1985 was approximately $139 million. They have computed that the portion of the performance funding system attributable to insurance amounts to only $41 million.

These figures reflect that public housing authorities have had to absorb $100 million of additional insurance costs during 1985 without receiving additional dollars to cover those costs.

I need not take the time to indicate to you what that has done to housing authority budgets and, more importantly, service levels to residents. We consider this a crisis.

It is also anticipated that the cost of insurance will continue to increase in 1986 and widen that gap.

There are some 27 States which have mitigated these increases by a variety of restrictions and midterm cancellations and nonrenewals and/or increasing premiums while the policies are in effect. When these policies expire, we will see a flood of increases and/or cancellations.

Previous efforts by NAHRO chapters and other groups resulted in group policies in a number of areas. Unfortunately, many of these group policies have suffered in the past 2 years and have not been renewed.

Another major area of concern for our agencies is coverage of commissioners of public housing agencies. Since 1982, 1,200 housing authorities have obtained coverage for their housing commissioners. There is currently only one company in the country writing commissioners' liability insurance. My understanding is they now cover 500 PHA's and are 6 months behind in writing policies. The other 700 PHA's no longer have commissioners' insurance and cannot obtain it.

In addition, the total cost for commissioners' insurance coverage in 1985 exceeds the cost in 1982 for less than half the agencies securing that coverage.

A cause specific to our agencies is the lack of knowledge and the unwillingness to get that knowledge by major carriers of the real nature of the assisted housing and development business.

These insurers are generally governed by bad images they have of our programs and make no effort to determine whether these images are accurate.

Closer scrutiny by underwriters would reveal that generally housing authorities are not innately bad risks.

Another overriding problem is that most insurers view our agencies as an extension of general local government. Unfortunately, these same insurers view general local government as significant insurance risks, since many view local government as having a deep pocket.

The deep pocket syndrome is transferred to our housing and community development agencies.

Senator HECHT. Mr. Nelson, your 5 minutes is up, so please summarize within the next minute.

Mr. NELSON. The solutions that we would propose are: One, that the Congress particularly fund housing authorities to cover that gap in the increased costs that they incur to acquire insurance.

We also support passage of the amendment to the Risk Retention Act and encourage that the act be expanded to include property coverage, also.

In conclusion, let me repeat that public housing authorities are facing an insurance crisis today. Help is needed. Solutions must be found. The problem is clearly not of the making of the local agencies. The solution also should not be expected to be the sole responsibility of local agencies.

A working partnership in resolving this crisis is essential. This partnership must include the Congress, HUD, the insurance industry and local agencies and their representatives.

Thank you very much for the opportunity to express our views on this very important subject.

[The complete prepared statement follows:]

2. When it was evident that the survey results would not support our position that a true crisis exists in the property/casualty market, we withdrew the request for legislation that would have permitted HUD to form a self insurance fund.

3. The inherent shortcomings in the report made it impossible to issue any definite findings and/or conclusions.

4. The Office of Public Housing is always available to discuss any matter dealing with the insurance crisis.

I would like to assure you that the Department is very concerned over the cost and availability of insurance for PHAs. We are working with a number of interested groups to find a viable answer.

Sincerely,

for Thomas Sherman
James E. Baugh, Ph.D.
General Deputy Assistant Secretary

ATTACHMENT C

CLPHA
Council of Large Public Housing Authorities

May 2, 1986

PHAs that have been granted waivers of ACC requirements by HUD for fire or liability coverage.

Houston, Texas	(F)	
Stark Metropolitan, Ohio		(L)
Columbiana Metropolitan, Ohio		(L)
Contra Costa, California	(F)	(L)
Beaver County, PA		(L)
Cook County, IL		(L)
San Mateo, CA		(L)
Carbondale, PA	(F)	
Livermore, CA		(L)
Mendocino, CA		(L)
Reading, PA		(L)
Aurora, IL		(L)
Schuylkill, PA		(L)
Bay City, TX	(F)	
South San Francisco, CA	(F)	(L)
Pleasantown, CA	(F)	(L)
Bay St. Louis, MISS	(F)	
Pottsville,VA	(F)	
Shellman, ALAB		(L)
Caruthersville, Region VII	(F)	(L)
Autlers, Region VI		(L)
Allentown, Region III		(L)
Mississippi Regional	(F)	(L)
Lackawanna, Region III		(L)
Picayune, Region IV	(F)	
Philadelphia, Region III		(L)
Savannah, Region IV	(F)	
New Orleans, Region VI		(L)
Corpus Christi, Region VI	(F)	(L)
Orange, Region VI	(F)	
Pasco County, Region IV		(L)
Beaumont, Region VI		(L)
Galveston, REgion VI	(F)	
Guthrie, Region VI		(L)
Stillwater, Region VI		(L)
Tipton, REgion VI		(L)
Springfield Metro. Region V		(L)
Rockford, Region V	(F)	
Bethlehem, Region V		(L)
New Bedford, Region I	(F)	
Baltimore, Region III		(L)
South Hutchinson, Region VII	(F)	(L)
Minneapolis, Region V		(L)
Marion County, Region V		(L)

(cont.)

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St. Louis County, Region VII	(F)	
Baxley, Region IV		(L)
Brownwood, Region VI		(L)
City of York, Region III		(L)
Comer, Region IV	(F)	
Topeka, Region VII		(L)
Madera, Region IX	(F)	(L)
Benicia, Region IX	(F)	(L)
St. Louis, Region VII		(L)
Syracuse, Region II	(F)	(L)
Fort Lauderdale, Region IV		(L)
Jacksonville, Region IV	(F)	
Sarasota, Region IV		(L)
Adairsville, Region IV		(L)
Wilmington, Region III	(F)	
Buford, Region IV		(L)
Fort Worth, Region VI		(L)
Buchanan, Region IV		(L)
El Paso, Region VI		(L)
Weatherford, Region VI		(L)
Maud, Region VI		(L)

Approximately 17 PHAs have been granted waivers of both fire and liability coverage in order to join the Illinois pool.

Waivers have been applied for and are pending on the following PHAs:

Hialeah		(L)
Montgomery		(L)
Port Isabel		(L)
Chicago	(F)	
Brevard	(F)	
Alameda		(L)
Richmond	(F)	(L)
Roanoke	(F)	
Pahokee		(L)
Augusta	(F)	
Union Point		(L)
Greensboro		(L)
Lincolntown	(F)	

ATTACHMENT D

CLPHA
Council of Large Public Housing Authorities

May 2, 1986

Insurance problem of the Jersey City (NJ) PHA, and failure of HUD to provide backing to the PHA.

HUD is signing waivers to ACC requirements that PHAs have adequate property and liability insurance coverage. When HUD Asst. Sec. Lindquist described this "new HUD policy approach" in 1985, he told CLPHA representatives attending a meeting with him that HUD would "of course" have to help PHAs that got in trouble if they were sued and had no insurance coverage. Asst. Sec. Lindquist is no longer with HUD. The following is the kind of backing HUD is giving to a PHA that thought it was covered by insurance.
In light of this lack of support, it seems very difficult to assume that HUD would take a more supportive approach in the case where a PHA had gone bare based upon approval of a waiver of insurance requirements, signed by HUD. Caveat non-emptor.

In Jersey City, a child was hit on the head by a bicycle thrown from the 10th floor of one of the high-rise developments and suffered significant brain damage as the result. A major liability judgment against the Authority, in excess of three quarters of a million dollars, was upheld through Appeals by the Authority to the New Jersey Supreme Court. Since that time, the insurance company (Ambassador Insurance) has gone bankrupt, and the PHA has therefore been left without a source of funds to pay the judgment.

HUD has taken the position that it has no responsibility in any way to back, hold harmless or assist the PHA in this case. HUD also argues that it should not be a party to even discussing the issue with the Court, with an eye to settling on the final award. HUD has further taken the position that the PHA itself should not pay any money out of its own funds for this judgment, and instead should claim a governmental entity exemption. The PHA believes that in light of the fact that the New Jersey Supreme Court has upheld the judgment, some payment is inevitable, and that HUD's position is irresponsible.

The PHA is instituting a suit against Counsel for the insurance company for not notifying its clients that the insurance company's fiscal status was at least tenuous if not in serious jeopardy. HUD has told the PHA that it needs HUD's permission before it can go ahead and pursue any such legal action on its own HUD's Regional Office has made no positive recommendations for actions or moving toward a solution, simply telling the PHA to do nothing, and that HUD will do nothing, either. There is no claim that this is the policy coming from the HUD Central Office, only that these are the instructions of the HUD Regional Office.

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The possible award is now in the range of an excess of $1 million, due to interest since the date of the original judgment, which has now been upheld. The PHA says it has no way of paying this amount, and doesn't have the funds in any reserves it could use to pay. The amount is equal to about 10% of their annual operating expenses, and about 20% of their annual federal operating subsidy. If the PHA had to pay it, it would all have to come out of that part of the PHA's budget which does not represent fixed costs. The PHA is arguing in Court that this would cause irreparable harm to its other functions. The PHA is also seeking a variety of alternative solutions, including amendments to state legislation that would provide assistance to those put in jeopardy as a result of the insurance company's bankruptcy.

These prudent actions on the part of the PHA in seeking a solution, however, have no bearing on the fact that HUD's position in telling the PHA simply "don't do anything" is clearly unreasonable in light of the current situation and the Supreme Court's decision.

Other PHAs that are going bare with HUD's approval might wish to think about this. It clearly could happen to you, too.

APPENDIX E

Public Housing

HOUSING AUTHORITY NOT LIABLE TO PASSERBY FOR ATTACK IN PROJECT

The New York City Housing Authority is not liable to a passerby who was forced into a public housing project and assaulted by a stranger, the New York Supreme Court, Appellate Division, Second Department, has declared, rejecting the contention that the housing authority's duty of care extended to "all persons who regularly traffic the city streets and sidewalks." *(Waters v. The New York City Housing Authority, April 21, 1986)*

The incident occurred on July 25, 1982, when a woman was accosted at knifepoint by an unknown assailant on a public street and compelled to accompany him to a nearby building, which happened to be a New York City Housing Authority project. The injured woman claimed the Housing Authority was negligent by failing to provide locks on the front door of the building. The locks had been broken for two years, and during that time a number of crimes had been committed against the tenants after assailants gained entry into the building.

The housing authority maintained it owed no duty to the passerby who was neither a tenant nor a guest to protect her from the intentional actions of the assailant. The trial court agreed with the defendant's contention, saying it was unwilling to stretch the concept of duty and liability to such extensive parameters.

The trial court stated that "a determination that the NYCHA was negligent in regard to the incident in question presupposes that their duty extends to any and all possible incidents (however remote) which might result in an individual taking advantage at any time, under any circumstances, of the fact that the NYCHA allowed a door to be unlocked in the early hours of the morning."

Appellate Court Ruling

The appellate court concurred with the trial court's judgment.

The court observed there would be enormous "potentially deleterious ramifications of allowing the plaintiff's claims. . . . To subject property owners to such boundless liability is, in our view, grossly unfair."

The court went on to explain that sustaining the plaintiff's claims "under these circumstances is to set the groundwork for dangerous precedent, i.e., that property owners who fail to secure their property with locks do so at their peril and risk liability to anyone injured thereby, regardless of the relationship. Recognition of the plaintiff's claims would result in the imposition of an unfair onus upon a public corporation whose duty is not to insure public safety for those in now way connected with the property, but rather, to provide housing for those in need."

Dissent

The dissent asserted that the question centered "not on the duty of a landlord to control the criminal acts of third parties, but rather on the duty of a landlord to maintain its premises in a reasonably safe condition." Moreover, the dissent said, the fact that the actual cause of the injury was the criminal act of a third party does not immunize the housing authority from liability.

"Where a defendant's acts or omissions create a situation in which the possibility or likelihood of criminal activity could reasonably have been anticipated, and the defendant's conduct has created or increased the risk of harm, the intervening act of third person will not insulate the original wrongdoer from liability and the intervening act will not constitute a break in the chain of causation," the dissent declared.

Furthermore, "(t)he simple expedient of ensuring that locks are kept in proper working order does not impose an unreasonable burden upon property owners and does not involve prohibitive costs. I simply fail to see the 'deleterious ramifications' of so minimal a precaution," the dissent stated.

NAHRO

Statement of

RICHARD Y. NELSON, JR.

Deputy Executive Director/
Legislative Counsel

National Association of Housing and Redevelopment Officials

On

The Public Housing Insurance Crisis

Before the

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

of the

SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

May 15, 1986

INTRODUCTION

Mr. Chairman and members of the Subcommittee, I am Richard Y. Nelson, Jr., Deputy Executive Director and Legislative Counsel of NAHRO. As you know, NAHRO is an association of professionals who administer low-income housing, rehabilitation, and community development programs in localities across the country. Over 5,500 individuals and 2,200 local agencies involved in carrying out these programs belong to our national organization. Our agency members manage over 1,000,000 units, or 84 percent of the existing public housing stock, over 500,000 Section 8 Existing units, and represent cities with $900 million in CDBG grants. These members and those active in our regions and state chapters and associations enable us to effectively represent a broad spectrum of those engaged in administering these programs.

I come before you today to discuss the liability insurance crisis as it is impacting on our members and some suggestions for dealing with this crisis. Since most of the data we have collected, to date, relates to the public housing program, that will be the focus of my testimony. This should not be interpreted to mean that the problem is not as severe for those with CDBG programs or other assisted assisted housing who are experiencing grave difficulties in securing affordable liability insurance coverage. The crisis affects all of the agencies administering the HUD assisted programs.

It is my intent, through a description of the current status of the insurance problem, to point out the severity and significance of the problem to our agencies. Unfortunately, the Administration is taking the position that the insurance problem is not severe and, as a result, does not require intervention by HUD. I appear before you today to tell you that this assessment of the severity of the problem is wrong. We are truly facing a crisis.

Senator HECHT. Thank you for this very, very informative dissertation.

Senator Dodd is on a timeframe, so I am going to let him start off with the questioning.

Senator DODD. Thank you very much, Mr. Chairman.

Let me, if I can, before raising some questions for this panel—I have three or four short questions for the panel that will be following—I think it is the last panel we have before us, or the second to the last, the one from the insurers themselves.

I would ask unanimous consent, Mr. Chairman, that those questions be addressed or submitted.

Senator HECHT. Without objection, they will be.

Thank you.

Senator DODD. Let me, if I can, just the three of you here, you have all alluded to, and I gather the other panelists have as well, we all know the problem that we are talking about, the horror statistics, and so forth, that affect us. It has become simple enough to identify the problem.

The question is: What is the solution, obviously, and how can you come up with a solution that is politically acceptable?

I don't even like to use that word, but the tensions on this issue politically are such that you have got to keep that in mind when you are dealing with this problem.

The Kasten bill 1 or 2 years ago failed, you will recall, because it just didn't have the kind of political support from various groups that it needed. Frankly, I didn't happen to agree with that bill myself. It was deficient in a number of ways.

Just this last week or so, Senator Danforth and I submitted yet another alternative. We have been working at this for a couple of years. In fact, Senator Gorton of this committee as well has also done a great deal of work on the subject matter.

I don't know if all three of you are familiar with the most recent effort we have submitted as an amendment to Senator Danforth's original S. 1999 bill.

OUTLINE OF BILL

Are you familiar with that, the most recent one?

Let me just outline it for you briefly. I realize I am giving you an outline, which is not necessarily fair, but I would like you to listen to it for a second and comment if you could on it. If you can't, if you would submit a written response to it. We would like to get some sense.

I am going to ask—I guess I can get it here without any difficulty—I will ask unanimous consent, since there is no one here to object. [Laughter.]

I wonder if there is anything else we want to do here this morning. [Laughter.]

Oops, here he comes again. I am sorry, Mr. Chairman. I almost got rid of the nonbank banks here as well. [Laughter.]

Let me just outline this for you briefly and then ask you to respond to it, and I will ask the other panels as well to do so with the actual text of the bill. This is just a brief outline.

The basic approach is the following. This is, Mr. Chairman, the most recent bill that Senator Danforth and I have submitted dealing with product liability.

First of all, a person injured—and I will read down here the summary, so I can get all the points as briefly as possible—the person injured by a product would have a choice as to where to seek recovery.

Choice 1 would be to file a claim against the manufacturer, as we have suggested before. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries only.

In this regard, the pain and suffering dollars would go to the neediest, as they now do under the good no-fault auto insurance laws. Any disagreements as to the appropriate amounts would be submitted to arbitration.

That is choice No. 1.

Choice No. 2 would be where a claimant files a lawsuit. In that suit the manufacturer would seek to settle the claim on the above terms; that is, the choice No. 1 terms. If, however, the manufacturer makes such an offer and the claimant turns it down, then and only then would the manufacturer be the beneficiary of three changes in the tort system.

One, there would be a cap on pain and suffering of $250,000; two, no payment for damages covered by other sources, abolition of the collateral source doctrine, and so forth; and, third, restriction of joint liability to net economic losses.

If the manufacturer refuses to make the settlement offer along those stipulated lines—this is choice No. 3—then the claimant may proceed with his or her lawsuit with few substantial changes in the tort system, with the exception of a limit on punitive damages to twice the amount of compensatory damages. If the claimant recovers, the claimant would also receive an additional award equal to 25 percent of the judgment.

What we are trying to do here is sort of a carrot and stick incentives, back and forth, to try and channel people into a settlement approach, yet not forcing them into that approach.

This has been a very cursory explanation, but I wonder if you might comment on what I have just explained as to whether or not this would meet some of your concerns.

Mr. FITZGERALD. Recognizing that the association I am speaking for today, Senator, does not have a position on that bill, personally I think that the concept of arbitration and trying to set up some encouragement to arrive at solutions like you are looking for is exactly what is needed.

A lot of my work deals in labor relations, and we have binding arbitration for a majority of the issues that we face. The very threat of arbitration forces both sides to be much more realistic about what ought to be achieved and what can be achieved.

An arbitration is used rarely, quite infrequently, but the fact that it is there forces both sides to discuss the thing a little more objectively, and I think it is the kind of thing we ought to see more of.

Senator DODD. Thank you. Ms. Russ.

Ms. **Russ**. Thank you again. Since this is brand new to me, I'm not speaking on behalf of CLPHA, but simply on behalf of myself.

BENEFITS OF ARBITRATION

I agree with Mr. Fitzgerald that any time we can have a situation that encourages both parties to a dispute to come together and try to discuss it prior to litigation, litigation being the last resort, I think it will benefit everyone in the long run. We, I'm sure, like Mr. Fitzgerald and many others, do suffer a certain number of nuisance lawsuits and also some legitimate ones. This will be of benefit in both cases.

Mr. **Nelson**. I think your suggestion does help, in terms of setting up one solution to a problem. I would like to be able to respond more in detail, after we look at how it applies to public housing authorities. I think there are some opportunities there to help us with our problem.

Senator **Dodd**. I will see to it that all you get specific copies. I should tell you that Senator Danforth and I, there is nothing in concrete in this at all or anything etched in marble, so to speak, where we've been trying, over the last couple of years, to find that solution that would make the most sense and reduce, obviously, the problems we are all aware of, the availability, the affordability, the rising costs, and the like, for everyone. So I would appreciate your commenting. And again, the basic motivation behind it is the recognition that if plaintiffs, particularly, were aware of the fact that they can be made whole, and obviously, in the cases where there are serious injuries and death or permanent injuries, pain and suffering questions should not be just put aside, where they can be made whole and made whole quickly, relatively quickly, and actually be compensated for their actual damages, plus the pain and suffering that we've identified in those unique cases. Our suspicions are that more and more people would prefer that route than to wait the 5 years, which is the average wait or to see a good part of their resources. Our statistics are that for every $6 the plaintiffs collect, lawyers on either side get $7.

It takes a long time, and it is costly. So again, no one is committed to such a degree that there can't be any changes to this, but it will be very important to us, if you could look at this and bring it before your organizations for comment as well and get back to Senator Danforth, myself, our staffs to share with us your views and comments on this particular approach. We would find that very, very helpful.

Mr. Chairman, I will ask, if it is appropriate, that we will submit that same question to the panels that have come before and will come after, to the extent they would care to comment, either individually or on behalf of their organizations, recognizing, of course, that all we've done here is outline very briefly what is in the bill, and obviously, they need to look at the specific language, before they make any formal declaration of support or opposition.

We would appreciate that very, very much.

Senator **Hecht**. Thank you, Senator. I am still trying to figure out, how for every $6 you collect, the lawyers get $7.

Senator DODD. In terms of the total amount of dollars spent. That is what I am talking about on either side. Lawyers on both sides.

Senator HECHT. I want to commend you and Senator Gorton for taking a lead role in developing a solution with Senator Danforth, and, in fact, if all of us can try to work together here, I think we can come up with something.

Thank you very much.

Incidentally, your questions will be submitted to all the panels.

Mr. Fitzgerald, in your testimony, you state that you consider the use of transit association captive insurance companies as an appropriate market solution likely to provide immediate benefit to those having to cope day to day with the need to provide coverage for liability risks. The economy could take a downturn and interest rates would rise, causing the premiums from commercial insurance to decline.

In light of this, do you still believe the captive insurance companies are the solution for mass transit systems, in the long run?

Mr. FITZGERALD. In the long run, I don't think that is necessarily the case, Senator. Your comment is right on the money, of course.

CYCLICAL NATURE OF INSURANCE INDUSTRY

Those of us who have been in this business for a while know that the insurance industry goes through this kind of a cycle generally every 8 to 10 years, but it has never been as bad as it is now. We think that one way to prevent that, of course, is for the appropriate Federal and/or State laws to be changed. Then we will have a more lasting effect.

All of us are grabbing at solutions that look good now and are probably good through 1987, but surely, the business cycle will change, and with it, some of those solutions will no longer look as good a year from now as they do in the present. If Congress and some of our State legislatures take some appropriate action, we won't be talking about it again in 8 years.

Senator HECHT. Mr. Nelson, would you care to comment on what I asked Mr. Fitzgerald?

Mr. NELSON. I think one of the reasons that we suggest the possibility of looking at the captive insurance company as a solution is that this would take us out of being subject to the cyclical nature of the private insurance business. We think that would be of particular benefit to the many housing authorities across the country and through our own managed company, we would be able to protect.

Senator HECHT. Mr. Fitzgerald, to the first panel, I asked a question which they obviously weren't prepared for. So I will ask you to think it over and ask you to submit it for the record.

Down the line, in perhaps 5 years from now, if we don't resolve this crisis, figure out in your own mind, what percentage of the fare of public transportation would be insurance. That would be an interesting figure for us to know.

Mr. FITZGERALD. Yes, sir; I'll provide that.

Senator HECHT. Do you have any idea now?

Mr. **Fitzgerald**. I can tell you right now, probably in the typical transit system, roughly 5 cents of the dollar is used for insurance.

Senator **Hecht**. I appreciate the fact that you are able to estimate the 5 percent. What do you anticipate 5 years from now?

Mr. **Fitzgerald**. I don't know what the percent will be, because to work that out, you have to make some assumptions about what is going to happen to the rest of the operating expenses. But it is the fastest growing component of the budget right now. So I would say the sky's the limit, depending on what happens to labor.

[The following information was subsequently supplied for the record:]

American Public Transit Association

Answer. For two reasons, it is difficult to determine what portion of public transit fares would result from liability insurance costs in 5 years. First, the factors driving the liability insurance crisis—the nature of the insurance industry itself and the operation of the civil justice system—are likely to change in the next several years. Second, less than 100 percent of public transit costs are presently reflected or likely in the future to be reflected in fares. Currently, approximately one-third of operating costs are paid by fares.

Nevertheless, assuming the present 400 percent-a-year rate of increase in insurance costs—or 2,000 percent for a 5-year period—it is safe to say that insurance costs would represent a significantly greater portion of fares than is presently the case. The exact percentage would depend upon the relative increase of other expenses, such as fuel, labor and spare parts. We do not envision a 2,000-percent increase in these terms. Therefore, the bite that insurance costs take out of fares, as well as out of public support and other income, is likely to be a significantly greater percentage than is the case today, but immeasurable at this time.

Senator **Hecht**. Thank you. I will ask this to anyone who might want to answer.

Clearly, the cost of liability coverage affects operating expenses of both public housing and mass transit systems. Please comment on the budgetary implications at the Federal level of continued escalation of insurance premiums.

Ms. **Russ**. I would like to respond to your first question. I can't respond for all of CLPHA, but I can respond for the Wilmington Housing Authority. In terms of our expense last year, our insurance costs were 1½ percent of our total operating costs. This year, they are 5 percent. Next year, we are hoping they won't be more than 7 percent. And that is hope against hope. We may do worse. We are lucky. We are insured. We are one of the fortunate housing authorities. We are not bare.

I think what this is going to do in public housing is different from what it is going to do in other agencies, because unlike other agencies—well, private agencies, but very much like the transit agencies, we can't pass cost increases through to our consumers. Our rents are regulated. Our subsidy formula is regulated, and HUD is presently taking the position that this isn't serious, and we are not going to increase your subsidy to make up for the differential that you are paying. We are going to be bankrupt. That is what is going to happen to us.

Senator **Hecht**. First of all, thank you for that answer. I am very impressed that you knew the exact figure. Basically, if you had the same increases in the next 5 years, you'd be paying 25 percent insurance costs.

Ms. **Russ**. Yes. We couldn't live. We wouldn't last that long.

Senator HECHT. What would you do?

Ms. RUSS. I don't know. As a result of our insurance this year, I have cut staff to what I consider to be the bare minimum to deliver basic services, and that staff cutting is your last resort. I mean, you cut everything else first, because this is very service- and staff-intensive business. If we experience the same kind of increase next year as we experienced this year, which is a 400-percent increase, we would begin cutting services. And at some point you can't cut services any more and still deliver your product.

Senator HECHT. Thank you. Mr. Nelson, did you want to comment on that?

Mr. NELSON. The comment I was going to make is, that if you look at the figures in our testimony, we indicate that the cost for insurance alone is 10 percent of the amount funded for operating subsidies by the Federal Government in the national budget which relates to what Ms. Russ was saying, in terms of the ability of PHA's to get additional money. The only increase that the PHA sees in operating subsidies to cover the cost of increased expenses is roughly that which is equivalent to the inflationary increase. So if we look at a year of 4 or 5 percent inflation increase in that year, we will see 5 percent more in operating subsidies, but we've indicated the escalation in premiums is in the 400- to 500-percent range. That money has to come from somewhere. It can't come from the residents who are already paying the maximum.

Therefore, the only solution is to go bare or to further reduce services and staff for the residents of our public housing projects.

$3 TO $3.5 MILLION MINIMUM TO ESTABLISH A POOL

Senator HECHT. Thank you very much.

To anyone on the panel, what would be an estimated minimum amount of capital necessary to form a public housing authority or transit authority pool to cover general liability?

Mr. NELSON. The estimate that we have, and I would not at this point commit to the fact that it would be enough or that it is as firm as I would like to see it, but the preliminary estimate that's been provided to us is something in the neighborhood of $3 to $3.5 million.

Senator HECHT. What Federal regulatory requirements that are imposed upon public housing authorities or transit authorities that contribute to the problems of availability and cost of insurance?

Ms. RUSS. First of all, we are required by our annual contributions contract with HUD to have insurance and to obtain that insurance by bidding in the present insurance markets. Most of us are experiencing the same thing when we go out to bid. Either no bids or bids that are so high that we can't even consider them. We are having to severely retrench and rethink our whole insurance approach. Those of us who have insurance, the lucky ones, have the cost of very high deductible self-insurance and reduced ceilings on coverage, and in some cases, reduced types of coverage. So the bidding requirement is at this point a time-consuming exercise that is really pointless.

Second, HUD's response to the fact that when we bid, we don't get anything, has been to say, well, you go out and you start negotiating. You do the best you can. If you can't get insurance, we will give you a waiver to go bare. That lets them off the hook, but it doesn't let us off the hook. You know, we are still there hanging out.

So that, to us, is not an equitable solution at all.

Mr. NELSON. If I may comment on the competitive bidding requirement. We have been told by some carriers that they will not bid on the public housing business, because of the fact that PHA's have to competitively bid at the expiration of the policy. The fact is, that in trying to reduce losses, you should develop a risk management program. That risk management program is one that is undertaken directly by the insurer and the public housing agency. It doesn't occur in just a 1-year period of time. It also requires a great deal of investment on the part of the insurer. They can't recoup that investment in the space of the one year and then be subject to losing out to a low bidder next year.

So it has definitely been an impediment in terms of getting a number of major insurers to participate in our program.

Senator HECHT. Has HUD been responsive to your concerns?

Mr. NELSON. Lately, they are willing to waive almost anything, but that's only because they have realized that there is a crisis, but one of the ways to be responsive to the concern is to eliminate that particular requirement.

Senator HECHT. Thank you.

Before we go on to the next panel, I would just publicly like to commend the staff for having such informed witnesses as we have had today, the first and the second panel. We have a lot of hearings in Washington, and I don't know when I have been so impressed with witnesses so well-informed and so knowledgeable on this subject.

You will be hearing from us in the future, and I hope we can continue to pick your brains. Thank you very much.

Lee Ruck and Stephen Chapple representing cities and counties. Mr. Ruck.

STATEMENT OF LEE RUCK, GENERAL COUNSEL, NATIONAL ASSOCIATION OF COUNTIES

Mr. RUCK. Mr. Chairman, my name is Lee Ruck, general counsel of the National Association of Counties.

We appreciate the opportunity to testify today and to express NACo's views that the subject of this hearing is really not a single crisis. As we see it, it is a convergence of a number of problems, all of which can be made capable of separate analysis, which are going to require separate solutions, and which hopefully can work together, as Senator D'Amato has said, as a coherent agenda to allow us to come out of this wilderness.

The separate problems, as we see it, can be loosely described as problems within the insurance industry, problems of liability in the Federal courts and problems of liability in the State courts.

NEED TO MOVE ON TO A SOLUTION

NACo is aware of the ongoing disputes between the insurance industry and its detractors—trial lawyers and others—as to who

CURRENT STATUS

NAHRO began bearing of severe problems in the insurance area from its members at the end of 1984 and during the beginning of 1985. Our members reported an increasing number of cancellations, non-renewals, inability to get some coverage at all, and/or significant increases in premiums. As a result of this, NAHRO formed a subsidiary corporation, the Housing and Development Insurance Group, to develop a national program of insurance for housing and community development agencies. The Housing and Development Insurance Group contracted with an insurance consultant to explore options and make recommendations on the most appropriate solution for the insurance problems facing these local agencies.

Our studies have shown that PHAs in the liability area are experiencing premium increases up to 1000 percent. The average increase is in the neighborhood of 400 to 500 percent. Even where the premiums are increased, deductibles have also increased. Small agencies carried very little, if any, deductibles and are now being given policies which call for up to a $5,000 deductible. Very large agencies are going with $10,000 and over deductibles. The combination of these major premium increases and significantly increased deductibles have proven fiscally disastrous to many PHAs.

The data we have collected indicates that average premiums for general liability coverage for local agencies have increased over 272 percent since 1982. From 1984 to 1985, the average premium increase in liability alone was almost $14 per dwelling unit from $10.43 per dwelling unit to $24.08. While this increase is significant in and of itself, it should be noted that the figure would be higher except for the fact that many agencies are in the middle of extended term contracts with no premium increases and a significant number of agencies currently have no coverage and therefore are not factored into the 1985 costs. We have been advised that HUD has to date authorized some 84

public housing authorities to go without insurance because of its unavailability or unavailability at a reasonable cost. While a number of very large housing authorities (e.g., Philadelphia, Baltimore, El Paso) are included, the 84 agencies include a variety of different size PHAs. Also, this number reflects only those that have, as of this date, reported to HUD their inability to get insurance and formally requested a waiver.

The Department of Housing and Urban Development has estimated that the actual cost of insurance for public housing authorities during 1985 was approximately $139 million. They have also computed that portion of the Performance Funding System (operating subsidies) which is attributable to insurance amounts to only $41 million for 1985. These figures from HUD reflect the fact that public housing agencies have had to absorb $100 million of additional insurance costs during 1985 without receiving additional dollars to cover those costs. I need not take the time to indicate to you what that has done to housing authority budgets and, more importantly, service levels to residents. We consider this a crisis.

It is also anticipated that the cost of insurance will increase in 1986 and widen the gap between expenditure and available resources. Further, current escalations have been mitigated by the fact that some 27 states have issued a variety of restrictions on mid-term cancellations and non-renewals and/or increases in premiums while a policy is in effect. When these policies expire, we will see a flood of increases and/or cancellations.

Previous efforts by NAHRO chapters and other groups resulted in group policies in a number of different areas. Unfortunately, many of those group policies have suffered in the past two years. Our Oregon Chapter had a group plan for housing authorities in the state which was cancelled by two successive carriers and has yet to find a new carrier. The Louisiana Housing Council Chapter of NAHRO was cancelled in April of 1984 and renewed only after a 300 percent increase. The New England states had a policy which was rewritten with a 200 to 500 percent increase. Both the group in Eastern Pennsylvania and the New York State Association of Housing and Redevelopment Officials' group program were cancelled and not renewed. PHAs had to seek individual coverage. This is an example of the fact that group policies are not as advantageous in this current insurance market as they have been in the past.

Another major area of concern for our agencies is "Director and Officers" liability coverage. These programs provided coverage for commissioners of public housing agencies. Since 1982, over 1,200 housing authorities received coverage for their commissioners. There is currently only one company in the country writing commissioners' liability. My understanding is that they now cover 500 PHAs and are six months behind in writing policies. The other 700 PHAs no longer have commissioners insurance and cannot obtain it. In addition, the total cost for coverage in 1985 exceeds the cost in 1982, yet less than half the number of agencies are covered. Even NAHRO had a policy which was offered to be renewed in 1986 at a 500 percent increase in premium over the 1985 level.

Others with more information on the insurance industry generally can discuss the causes of the crisis including depressed premiums in the early 1980s designed to increase cash flow for investment purposes, or the fact that the reinsurance market which consists mostly of overseas reinsurers has substantially dried up, thereby reducing the capacity of domestic insurers to offer this coverage.

A cause specific to our agencies is the lack of knowledge, and the unwillingness to get that knowledge, by major carriers of the real nature of the assisted housing and development business. These insurers are generally governed by bad images they have of our programs and make no effort to determine whether those images are accurate. In fact, closer scrutiny by the underwriters would reveal that generally housing authorities are not innately bad risks. Another overriding problem is that most insurers view our agencies as an extension of general local government. Unfortunately, these same insurers view general local government as significant insurance risks since many view local government as having a "deep pocket." The "deep pocket syndrome" is transferred to our housing and community development agencies. The reality is, we, as is true with general local government, have almost no pockets at all. Lastly, the competitive bidding requirements of the HUD programs cause some problems. Most carriers want to maintain a client for a number of years during which time the carrier will work with the client to reduce losses. This relationship requires more than one year to develop and also be cost-effective. Therefore, annual competitive bidding is a deterrent to such a commitment on the part of the carrier for there is no guarantee that the carrier will recoup his investment.

SOLUTIONS

Tort reform such as that proposed in S. 2038 and S. 2046 are options to be considered in addressing today's problems. Many states are also in the process of considering various forms of tort reform. However, in most cases these are long-term solutions and will not produce the needed relief in the short term. Short-term relief is what is essential for local housing and development agencies.

The most needed, and potentially immediate, relief which can be given to local agencies is funding by the Congress to cushion the blow of the significantly increased insurance premiums. In testimony before both Senate and House Appropriations Committees, NAHRO has requested that FY '87 appropriations include funding to cover the cost of increased premiums for local housing authorities. We have also requested specific language be provided to insure that HUD can pay for increased cost of insurance through the provision of the

Performance Funding System known as "costs beyond control." We strongly urge this Subcommittee to endorse both of those requests.

Again, in the short term, it is essential that the federal government support local agencies who are unable to secure adequate coverage through the private sector. Provisions should be made to financially support those agencies who have received waivers from HUD and are going "bare" of insurance. There should be a commitment that claims against the agency will be paid by the federal government. While NAHRO is not proposing this as a permanent solution, it is essential until a more long-lasting solution is discovered and implemented.

Another good approach is that proposed in S. 2129 which has been reported out by the Committee on Commerce, Science and Transportation. This bill amends the Product Liability Risk Retention Act of 1981 to facilitate the ability of organizations to establish risk retention groups. If this bill is enacted by the Congress, it will be a positive step and a potential solution for our problem. NAHRO is seriously considering the establishment of an insurance company which could use the provisions of the Risk Retention Act to provide coverage for our agencies. We have been advised by counsel that an organization such as ours would qualify under the proposed language of S. 2129. The primary advantage of this proposed revision to the Risk Retention Act is that an insurance company established by NAHRO or its subsidiary would not have to go through the process of being admitted in each of the 50 states. There are, however, two problems with our utilization of this vehicle, capitalization and reinsurance. Any insurance company established, or purchased, for these purposes must be capitalized at fairly substantial levels. We are currently considering options for accomplishing this objective. Any insurance company entering this area must also have some level of reinsurance. This level will be higher in the beginning of the program than later, but in any event reinsurance is necessary. As already indicated, the primary reinsurers have

significantly reduced their participation in reinsurance of liability programs. We have had some conversations with reinsurers and have reason to believe that there are prospects for reinsuracne. However, those prospects would be significantly improved if we were able to offer a multi-line of coverage; i.e., liability and property coverage. The Risk Retention Act is currently limited to liability lines only. We urge this Committee to take action to permit a group of local housing and development agencies to develop a self-insurance group or risk retention group which would provide both liability and property coverage.

Another part of the solution, and one which NAHRO will include in its program, is an intensified program of risk management training. There are areas where training is essential and can have a perceptible impact on loss reduction. This is a longer-term part of the solution, but essential part of any program.

In conclusion, let me repeat that the HUD-funded agencies are facing an insurance crisis today! Help is needed! Solutions must be found. The problem is clearly not the making of the local agencies; the solution also should not be expected to be the sole responsibility of the local agencies. A working partnership in resolving this crisis is essential. This partnership must include the Congress, HUD, the insurance industry, and local agencies and their representatives. The Congress appears willing, but I must say we need more than just hearings. We need action! HUD appeared willing six months ago, but has done little to deal with the larger problem in the past few months. The insurance industry appears unwilling to face up to the issue and deal with it. The fact is they too want to walk away from the local agencies and their problems.

Help us to develop and implement solutions to this crisis!

Thank you for the opportunity to appear before you today. If you would like additional data or information, we will be happy to provide what we can. I will also be glad to answer any questions you have.

caused this problem and how it occurred, and like has been stated by members of the subcommittee, we are tired of trying to argue as to who caused the problem, and wish to get on with the business of analyzing the elements of the problem, so that we can move on to a solution.

We don't believe that there are any national statistics on all counties, but a number of surveys within individual States suggest that right now between 25 and 30 percent of all American counties have either had their general liability insurance canceled or they have been given notice of nonrenewal at the next available term.

We have seen premium increases within the last year averaging between 200-300 percent; increases as large as 600 percent are not unknown.

We realize there must be some adjustment in the premium during the insurance cycle, but some of the sizes of increase do not seem to be justifiable.

Even where insurance is continued at an increased premium, coverages are usually reduced and entire areas of exposure are often excluded.

Senator Cranston mentioned his California experience. In California, there are only 29 of some 58 counties which currently have commercial insurance.

And in a total package, they are paying three times the amount of premium they paid last year, and their coverage has been reduced more than 50 percent, if you lump all the counties together.

So we are essentially paying even a greater factor in the amount of increase if you look at how much insurance that each dollar is buying us.

In Nevada, as the chairman pointed out, Douglas, Clark, and Washoe are bare. Carson City, Las Vegas, North Las Vegas are bare. The other 14 counties and 15 cities are suffering exposure of two to three to four times the amount of premiums they paid in their last annualization of their premium.

Now, Nevada is a very interesting example here because it makes a dramatic point which I believe relates to something Senator Mattingly said. That is, Nevada is a State where your State legislature has tried to address this problem, and has placed a liability cap on States and counties. But, yet, we are seeing exactly the same increases of premium in Nevada as we see in Oregon or Washington, or Georgia, or New York.

Even where States are trying to address this problem, at least at this point in the development of a coherent agenda and solution, State legislatures by themselves have not been able to solve the problem.

Now, Nevada's problem, for instance, doesn't come from any esoteric services. Most of your counties, at least, are not providing complex involvements in the social life of the community. They're providing basically two services—public safety and roads. The more roads that you build in Nevada, the more people you incarcerate or the more fires you're going to put out, the greater the additional exposure on your liability, and the greater the additional exposure that your counties are going to face on their insurance premiums.

Roads and public safety are two things that Nevada counties are not going to get out of the business of doing. Unlike Senator Sasser's small businesses, counties can't decide to sell xerox machines rather than provide public transportation.

PARTICIPATION AT FEDERAL LEVEL

Now, NACo is concerned about this ever expanding liability and we think that there are aspects which must be addressed at the Federal level.

We have created a national task force, as have other organizations, and we have been meeting all winter and spring and recently recommended a series of policies to our national board of directors; which, after substantial discussion, have now been adopted as NACo's policy.

Those are appended to our statement for the record.

Senator HECHT. Thank you. It will be in the record.

Mr. RUCK. In large part, these recommendations——

Senator HECHT. Mr. Ruck, your 5 minutes are up. I'll give you 1 minute to get it all together.

Mr. RUCK. They parallel in tort reform the issues of the White House Policy Council, but we believe there are certain things that you in Congress can address and must address as your part of the coherent agenda.

You must review potential civil rights liability in terms of litigation. You must again revisit antitrust concepts. You must take a look at the issue of risk retention that's coming up now and consider amendments which would allow local governments to be less liable to risk. We have supported and endorsed your consideration of Senator McConnell's bill, Senator Kasten's bill; we earnestly hope that you will work with your other levels of local governments, the States and the counties, to see if we can together address this particular problem.

[The complete prepared statement follows:]

NATIONAL
ASSOCIATION
of
COUNTIES

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STATEMENT

OF

LEE RUCK

GENERAL COUNSEL, NATIONAL ASSOCIATION OF COUNTIES

ON

INSURANCE LIABILITY REFORM

BEFORE THE

SENATE SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

THURSDAY, MAY 15, 1986

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MR. CHAIRMAN, I AM LEE RUCK, GENERAL COUNSEL OF THE NATIONAL ASSOCIATION OF COUNTIES (NACo)*. I APPRECIATE THE OPPORTUNITY TO TESTIFY TODAY BEFORE THE SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS.

THE LIABILTIY INSURANCE CRISIS HAS MANIFESTLY AFFECTED THIS NATION'S THREE THOUSAND COUNTIES. THE SHORT TERM EFFECTS ARE POLICY CANCELLATIONS, INCREASED COSTS AND DECREASED COVERAGE. LONG TERM EFFECTS WILL BE THE EVER-INCREASING COSTS TO COUNTIES AND TO THE TAXPAYERS AND ULTIMATELY, CHANGES IN THE WAY WE DEFINE AND FINANCE LOCAL LIABILITY. LOCAL, STATE AND THE FEDERAL GOVERNMENT ALL NEED TO TAKE STEPS TO MITIGATE OR MINIMIZE THIS CRISIS.

NACo BELIEVES THE CURRENT INSURANCE CRISIS TO BE A CONVERGENCE OF SEVERAL PROBLEMS, ALL OF WHICH NEED ANALYSIS, AND EACH OF WHICH NEEDS INDEPENDENT SOLUTIONS FOR THE CRISIS AS A WHOLE TO BE ADDRESSED.

THESE SEPARATE PROBLEMS CAN LOOSELY BE DESCRIBED AS PROBLEMS WITHIN THE INSURANCE INDUSTRY, PROBLEMS OF LIABILITY IN THE FEDERAL COURTS, AND PROBLEMS OF LIABILITY IN THE STATE COURTS.

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*THE NATIONAL ASSOCIATION OF COUNTIES IS THE ONLY NATIONAL ORGANIZATION REPRESENTING COUNTY GOVERNMENT IN THE UNITED STATES. THROUGH ITS MEMBERSHIP, URBAN, SUBURBAN AND RURAL COUNTIES JOIN TOGETHER TO BUILD EFFECTIVE, RESPONSIVE COUNTY GOVERNMENT. THE GOALS OF THE ORGANIZATION ARE TO: IMPROVE COUNTY GOVERNMENT; SERVE AS THE NATIONAL SPOKESMAN FOR COUNTY GOVERTNMENT; TO ACT AS A LIAISON BETWEEN THE NATION'S COUNTIES AND OTHER LEVELS OF GOVERNMENT; ACHIEVE PUBLIC UNDERSTANDING OF THE ROLE OF COUNTIES IN THE FEDERAL-AID SYSTEM.

NACo IS WELL AWARE OF THE ONGOING DISPUTE BETWEEN THE INSURANCE INDUSTRY AND ITS DETRACTORS AS TO HOW THE CURRENT CRISIS WAS CAUSED. WE ACKNOWLEDGE THAT THERE IS BOTH AVAILABILITY AND AFFORDABILITY ASPECTS TO LIABILITY INSURANCE. ALTHOUGH THERE ARE NO KNOWN NATIONAL STATISTICS ON ALL COUNTIES, SURVEYS IN SEVERAL STATES SUGGEST THAT AS MANY AS 25-30% OF ALL AMERICAN COUNTIES HAVE EITHER HAD THEIR GENERAL LIABILITY INSURANCE CANCELLED OR HAVE BEEN GIVEN NOTICE OF NONRENEWAL. PREMIUM INCREASES OF 200-300% SEEM TO BE THE NORM, AND INCREASES AS LARGE AS 600% ARE NOT UNKNOWN. WE ACKNOWLEDGE THAT SOME INCREASE IS NECESSARY AS THE INSURANCE INDUSTRY WENDS THROUGH ITS CURRENT CYCLE. HOWEVER, INDIVIDUAL INCREASES DO NOT SEEM JUSTIFIABLE. ADDITIONALLY, WHEN INSURANCE IS CONTINUED, EVEN AT AN INCREASED PREMIUM, COVERAGES ARE USUALLY REDUCED AND ENTIRE AREAS OF EXPOSURE OFTEN EXCLUDED.

IN NEVADA, FOR EXAMPLE, DOUGLAS, CLARKE, AND WASHOE COUNTIES ARE WITHOUT INSURANCE-- IN COMMON PARLANCE, THEY ARE GOING "BARE". THIS IS ALSO THE CASE WITH THE CITIES OF LAS VEGAS, NORTH LAS VEGAS AND THE COMBINED CITY-COUNTY GOVERNMENT OF CARSON CITY. ACCORDING TO THE NEVADA ASSOCIATION OF COUNTIES, THE REMAINING 14 COUNTIES AND 15 CITIES IN THE STATE HAVE HAD DRAMATIC INCREASES IN THEIR PREMIUMS. WHAT MAKES THIS EVEN MORE DISTURBING IS THAT CANCELLATION, NONRENEWALS, AND DRAMATIC PRICE INCREASES ARE OCCURRING IN A STATE SUCH AS NEVADA, WHICH ALREADY HAS IN PLACE A STATE LAW PROVIDING FOR A $50,000 CEILING ON AWARDS AGAINST LOCAL GOVERNMENTS.

NEVADA'S PROBLEMS WITH INSURANCE DO NOT COME FROM ANY ESOTERIC SERVICE PROVIDED BY COUNTY GOVERNMENT BUT RATHER FROM THE TWO MOST BASIC AND COMMON SERVICES OF COUNTY GOVERNMENTS -- (1) ROAD AND HIGHWAY CONSTRUCTION AND MAINTENANCE AND (2) PUBLIC SAFETY. THE MORE MILES OF ROADS CONSTRUCTED IN NEVADA AND THE LONGER SENTENCES SERVED BY OFFENDERS, THE GREATER THE PROBLEM NEVADA COUNTIES WILL HAVE IN OBTAINING INSURANCE.

NACo IS CONCERNED ABOUT THE EVER EXPANDING LIABILITY PLACED UPON COUNTIES BY CONGRESS IN THE FEDERAL COURTS, BY EXPANDED THEORIES OF CIVIL RIGHTS LITIGATION, CONTINUING ANTITRUST EXPOSURE, AND THE POTENTIALLY DISASTROUS CONSEQUENCES OF HAZARDOUS WASTE LITIGATION. THESE ASPECTS OF THE LIABILITY PROBLEM CAN ONLY BE ADDRESSED AT THE FEDERAL LEVEL.

IN STATE AFTER STATE, COUNTIES ARE HELD LIABLE IN SEEMINGLY EVER-INCREASING AREAS OF PUBLIC ACTIVITY, ACTIVITIES WHICH WE ARE POLITICALLY AND OFTEN LEGALLY UNABLE TO LIMIT OR ESCAPE.

IN RESPONSE TO THE WIDESPREAD DEMAND FROM OUR MEMBERSHIP, NACo HAS CREATED A NATIONAL TASK FORCE ON COUNTY LIABILITY AND INSURABILITY, COMPOSED OF MANY MEMBERS OF OUR ELECTED POLICY LEADERSHIP AND MANY COUNTY PROFESSIONALS IN THE MOST IMPACTED AREAS OF PUBLIC SERVICE. AFTER MONTHS OF STUDY, THIS TASK FORCE HAS COME FORTH WITH SPECIFIC RECOMMENDATIONS WHICH WERE APPROVED BY NACo'S BOARD OF DIRECTORS IN APRIL. THESE POLICIES ESSENTIALLY ENDORSE NATIONAL AND STATE MODIFICATION TO THE CIVIL JUSTICE SYSTEM--"TORT REFORM"--AND OFFER SPECIFIC RECOMMENDATIONS TO THE CONGRESS FOR AMENDMENT OR ENACTMENT OF SPECIFIC STATUTES.

IN LARGE PART, THE RECOMMENDATIONS OF THE NACo TASK FORCE CONCERNING TORT REFORM PARALLEL THE RECENT POLICY PAPER PRESENTED TO THE ADMINISTRATION'S DOMESTIC POLICY COUNCIL. NACo'S RECOMMENDATION IN THIS REGARD TO CONGRESS AND TO OUR STATE ASSOCIATIONS AND INDIVIDUAL MEMBER COUNTIES ADDRESSING THIS ISSUE BEFORE STATE LEGISLATURES IS TO FOCUS ON PROCEDURAL IMPROVEMENTS TO THE CIVIL JUSTICE SYSTEM AND LIMITATIONS ON CERTAIN KINDS OF JUDGMENTS WHICH HAVE BEEN RECENTLY REPEATED AGAIN AND AGAIN.

WITH REGARD TO SPECIFIC POTENTIAL ACTIONS BY CONGRESS, NACo ENDORSES SENSITIVE, SURGICAL AMENDMENTS TO 42 USC SECTION 1983 TO INSURE THE CONTINUED VIABILITY OF THAT STATUTE AS AN ENGINE FOR CIVIL RIGHTS, BUT WHICH WOULD PRECLUDE ITS USE IN MANY CIRCUMSTANCES MORE COMMERCIAL IN CHARACTER. NACo ENDORSES THE CONCEPT OF LIMITATIONS ON JUDICIALLY AWARDED PLAINTIFF'S ATTORNEYS' FEES, BOTH IN AMOUNT AND IN THE SPECIFIC CASES IN WHICH THEY CAN BE AWARDED.

NACo SUPPORTS MANY OF THE PROVISIONS CONTAINED IN S. 2046, SPECIFICALLY PROVISIONS FOR PERIODIC PAYMENTS, THE COLLATERAL SOURCE DOCTRINE, AND PUNITIVE DAMAGES.

IN ADDITION TO THESE SPECIFIC CONCERNS FOR LIMITING LIABILITY, NACo IS AWARE OF OUR OWN RESPONSIBILITY IN LIMITING COUNTY EXPOSURE BY IMPROVED RISK MANAGEMENT IN THE PROVISION OF PUBLIC SERVICES. TO THIS END, NACo IS CURRENTLY DESIGNING A PROGRAM TO INTRODUCE MODERN CONCEPTS OF RISK MANAGEMENT TO OUR COUNTIES AND TO PROVIDE MANUALS AND TRAINING SESSIONS FOR COUNTY RISK MANAGERS. IN THIS WAY, WE BELIEVE THAT, WHATEVER MAY BE THE AREAS OF LIABILITY TO WHICH WE MUST RESPOND, WE WILL MINIMIZE INTERNAL AND EXTERNAL INJURIES AND, THERFORE, OUR FINANCIAL EXPOSURE. WE ARE ALSO ENDORSING AND SUPPORTING THE CONCEPT OF POOLING BY COUNTIES OR OTHER CREATIVE MECHANISMS THAT FINANCE RISK WHEN COMMERCIAL INSURANCE IS NOT READILY AVAILABLE OR AFFORDABLE.

TO THAT END, NACo SUPPORTS THE CONCEPTS OF S. 2129 WHICH AMENDS THE RISK RETENTION ACT OF 1981, AND WOULD PERMIT GREATER OPPORTUNITIES FOR COUNTIES AND OTHER LOCAL GOVERNMENTS TO POOL THEIR RISKS.

MR. CHAIRMAN, WE BELIEVE THAT AMERICA'S COUNTIES ARE NOT CRYING WOLF. REAL PROBLEMS DO EXIST. NACo BELIEVES THAT IT HAS FASHIONED A SERIES OF PROPOSALS--FOR THE INDUSTRY, FOR LEGISLATURES, AND FOR OUR OWN CONTROL OF HIGH-RISK ACTIVITIES--WHICH TOGETHER CAN SUBSTANTIALLY REDUCE THE THREAT OF CATASTROPHIC LOSS TO AMERICA'S COUNTIES AND ULTIMATELY THE TAX PAYERS WHO ARE OUR MUTUAL CONSTITUENTS. WE ARE SUBMITTING A COPY OF OUR SPECIFIC POLICY RESOLUTIONS IN THIS REGARD FOR YOUR REVIEW, AND EARNESTLY REQUEST YOUR CONSIDERATION OF OUR VIEWS.

MR. CHAIRMAN, THIS CONCLUDES MY TESTMONY. I WOULD BE PLEASED TO ANSWER ANY QUESTIONS THAT MEMBERS OF THE SUBCOMMITTEE MAY HAVE.

NACo TASK FORCE
ON COUNTY LIABILITY AND INSURABILITY
PROPOSED RESOLUTION ON
THE CIVIL RIGHTS ACT OF 1871 (42 U.S.C. SECTION 1983)

WHEREAS, the National Association of Counties has long supported aggressive enforcement of civil rights in both state and federal courts; and

WHEREAS, the National Association of Counties has historically acknowledged the Civil Rights Act of 1871, 42 U.S.C. Section 1983, ~~as a~~ significant and necessary tool in the protection of the civil rights of persons injured or threatened by actions of state and local governments or their officials; and

WHEREAS, in recent years, many actions filed under 42 U.S.C. Section 1983 have subverted the original intent of this legislation and have been brought on behalf of corporations and other business associations, on behalf of persons asserting interests adequately protected by state law, and on behalf of persons asserting commercial or political interests having little or no relation to the human rights of American citizens or others within the jurisdiction of the United States; and

WHEREAS, alternative dispute resolution mechanisms have been employed successfully to resolve matters susceptible to litigation before judicial processes have been invoked, thus saving litigation expenses and reducing use of the court system; and

WHEREAS, in recent years, many actions filed under 42 U.S.C. Section 1983 have sought punitive or exemplary damages against units of local government -- damages which, if granted, represent unreasonable and unjustified drains on taxpayer dollars; and

WHEREAS, punitive damages, when awarded against officials or employees of a state or local government, often operate as a windfall for plaintiffs and plaintiffs' attorneys, thereby encouraging questionable or frivolous litigation; and

WHEREAS, in recent years, many actions filed under 42 U.S.C. Section 1983 have sought money damages for non-economic injuries far in excess of any reasonable amount justifiably supported by taxpayer dollars; and

WHEREAS, many federal juries and courts have rendered verdicts and have awarded judgments against counties and county officials far beyond the original intent of the Civil Rights Act of 1871; and

WHEREAS, these judgments represent undesirable and unjustifiable drains on taxpayer dollars; and

WHEREAS, these judgments and the financial uncertainty surrounding future claims under 42 U.S.C. Section 1983, have substantially contributed to the current crisis of the unavailability of affordable insurance for America's counties.

THEREFORE BE IT RESOLVED, that the National Association of Counties calls upon Congress to enact legislation which would preclude litigation under 42 U.S.C. Section 1983: brought by or on behalf of other than a natural person asserting individual rights; brought to assert commercial, business, or property rights other than claims based upon discrimination against a federally protected class of persons; brought to assert rights not based on the Constitution of the United States or substantive federal laws defining "human rights"; brought to assert rights which sound in contract or tort at common law; and brought to assert rights for which there exists an adequate state remedy which fully permits consideration and determination of the federal rights asserted.

THEREFORE BE IT FURTHER RESOLVED, that the National Association of Counties calls upon Congress to enact legislation which would require that any punitive damage award against a local government or an official or employee of a state or local government, pursuant to 42 U.S.C. Section 1983, shall not be paid to plaintiff but, rather, to the Treasurer of the United States for use of the Administrative Office of the United States Courts and the Federal Judicial Center.

THEREFORE BE IT FURTHER RESOLVED, that the National Association of Counties calls upon Congress to enact Legislation which would preclude a money damage award under 42 U.S.C. Section 1983 in excess of $100,000 for any non-economic injury or loss.

THEREFORE BE IT FURTHER RESOLVED, that the National Association of Counties calls upon Congress to enact legislation which would preclude the award of damages under 42 U.S.C. Section 1983 if the court finds that the unit of government or officials thereof were acting in good faith.

THEREFORE BE IT FURTHER RESOLVED, that the National Association of Counties calls upon Congress to enact legislation establishing an alternative dispute resolution process and requiring that all parties participate in such process prior to commencing litigation pursuant to 42 U.S.C. Section 1983.

Passed by Task Force - April 1, 1986
Adopted by Board of Directors - April 2, 1986

NACo TASK FORCE
ON COUNTY LIABILITY AND INSURABILITY
PROPOSED RESOLUTION ON
THE AWARD OF ATTORNEYS' FEES TO A PREVAILING PARTY

WHEREAS, the American Rule is that each party to litigation should bear his own legal expenses; and

WHEREAS, the National Association of Counties endorses the concept that in certain instances, reasonable legal fees should be afforded a prevailing party; and

WHEREAS, in many instances in Federal Courts, prevailing plaintiffs are granted attorneys' fees not reasonably related to the success of the litigation.

NOW THEREFORE BE IT RESOLVED, that the National Association of Counties endorses remedial federal legislation which would reduce or limit plaintiff's attorneys' fees in those instances where such fees are not reasonably related to a successful component of the litigation or where such fees are not reasonably related to the economic or social value of a judgment or the economic value of a settlement; and

BE IT FURTHER RESOLVED, that the National Association of Counties endorses legislation limiting attorneys' fees awarded against units of government or officials thereof to $75.00 per hour and precluding the use of multipliers or bonuses; and

BE IT FURTHER RESOLVED, that the National Association of Counties endorses legislation which clearly states that where defendant units of local government or officials are prevailing parties, they are entitled attorneys' fees determined in the same manner as for prevailing plaintiffs.

Passed by Task Force on April 1, 1986
Adopted by Board of Directors on April 2, 1986

NACo TASK FORCE
ON COUNTY LIABILITY AND INSURABILITY
PROPOSED RESOLUTION ON
ANTITRUST LIABILITY

WHEREAS, the United States Supreme Court has held, in Community Communication Co. v. City of Boulder, Colorado, that cities and other sub-state entities are subject to review under the federal antitrust laws; and

WHEREAS, the National Association of Counties has called upon Congress to adopt legislation providing to units of local government the same antitrust status as enjoyed by the states; and

WHEREAS, Congress has addressed certain antitrust concerns of counties by passage of the Local Government Antitrust Act of 1984;

THEREFORE BE IT RESOLVED, that the National Association of Counties calls upon Congress to adopt legislation to clarify the applicability of the federal antitrust laws to local government and to provide them with the same status as that enjoyed by the states, as long as the local government is operating within or pursuant to its general enabling legislation or authority.

BE IT FURTHER RESOLVED, that the National Association of Counties calls upon Congress to enact legislation which would preclude the entry of treble-damage monetary awards against local government officials and employees.

BE IT FURTHER RESOLVED, that the National Association of Counties calls upon Congress to enact legislation which would preclude the entry of treble-damage monetary awards against third parties subject to contract or franchise controls of a local government for actions taken at the request of officials of that local government.

Passed by Task Force on April 1, 1986
Adopted by Board of Directors on April 2, 1986

Senator HECHT. Thank you very much. The answer is, yes, I will. Mr. Chapple.

STATEMENT OF STEPHEN CHAPPLE, GENERAL COUNSEL OF THE U.S. CONFERENCE OF MAYORS

Mr. CHAPPLE. Thank you, Mr. Chairman. I am Stephen Chapple, general counsel of the U.S. Conference of Mayors. Most of the comments I'll make today are fairly tentative. The mayors are meeting in June with their annual meeting in San Juan and they'll be addressing all of these policy questions.

I will see those recommendations the mayors do adopt are provided to the committee.

Senator HECHT. Thank you.

Mr. CHAPPLE. In addition, last summer, the Conference of Mayors did survey 145 cities, which are summarized in my written statement. We are now conducting a much more comprehensive survey, which will also be available.

And with the Chair's consent, I'll also submit that for the record.

Senator HECHT. Thank you.

[See p. 102.]

Mr. CHAPPLE. The first point I want to make has to do with what Mr. Ruck said, and that is that the State legislatures very, very much have been trying to help us and to help their local governments. But something needs to be done at the national level because we keep seeing States like Nevada, that are passing fairly thoughtful legislation trying to protect their local governments, and it doesn't make much difference.

McCARRAN-FERGUSON ACT

Pennsylvania did the same thing. Part of our recommendation, at least we are recommending that the mayors adopt, is a look at the McCarran-Ferguson Act. If the insurance industry wants to be regulated by the States, then maybe their policies ought to be more responsive to State policies.

I have included the usual horror stories in my statement. Davenport, IA, facing a 3,000 percent increase and a couple of others that I could come up with that are simply unacceptable.

Another point we ran into on our survey is what you just heard from the public housing agencies. More often than not, it's impossible to get coverage at any price.

That runs into our conflicts with HUD and the competitive bidding rule. And also very often the State rules on competitive bidding.

You asked us to address the causes. I agree with Mr. Ruck that it's getting a little late to argue about the cause this morning. I addressed a little bit of what our thoughts were on the insurance industry's role in it in the period of high interest rates and lower interest rates in my statement.

The most important issue the cities and counties can talk to you about is that we're the deepest pockets of all. Finally, when the tort system fails and compensation isn't there, it has to come out of State and local governments, or their welfare agencies.

At the same time as we're supposed to be providing these basic services Mr. Ruck talked about, we still have to build streets, put out fires, and haul garbage.

The current rules on joint and several liability make it very attractive for plaintiffs' lawyers to try to find a way to get the local government with the deep pockets in on the cases. We need to consider those rules.

The welfare system, which is designed to take care of injured parties when the tort system fails, is one which also recognizes that a collateral source is the county welfare department.

And how often should a county have to pay both through the tort system and through its social welfare department?

I hope we can look at that issue as we design these bills. The Congress helped us quite a bit last year when they developed the Local Government Antitrust Act. More than anything else, that saved a lot of transaction costs. We actually weren't being found liable for antitrust actions because we weren't violating the laws.

But, meanwhile, we were going through 300 to 400 lawsuits with millions of dollars worth of attorneys' fees being expended on proving that we hadn't violated the laws. The relief you gave us last year has been very, very helpful in that.

Our specific recommendations have to do with the data gathering that the Federal Government has the resources and the national perspective to perform. First of all, to find out what the causes of this crisis are, and second of all, how to address them. I've already talked about McCarran-Ferguson. I really think that merits very serious consideration because Pennsylvania can't fix it and Nevada can't fix it no matter what they do for their local governments.

On the other specific policies, we really have to wait and see what the mayors say about it. I'm sure that they'll look for changes in the collateral source doctrine, and, also again we would want to look at the relationship between the public welfare system that States cities, and counties run as the insurers of last resort.

Thank you.

[The complete prepared statement and 145 city survey follow:]

NACo TASK FORCE
ON COUNTY LIABILITY AND INSURABILITY
PROPOSED RESOLUTION ON
ENVIRONMENTAL IMPAIRMENT LIABILITY

WHEREAS, many counties own or operate solid waste landfills and other disposal sites which may contain hazardous or toxic waste materials; and

WHEREAS, the Superfund (Comprehensive Environmental Response, Compensation and Liability Act of 1980 - CERCLA) and other federal environmental impairment liability provisions have been interpreted to impose strict liability upon persons or institutions owning or operating solid waste landfills or other disposal sites; regardless of fault; and

WHEREAS, the Superfund (Comprehensive Environmental Response, Compensation and Liability Act of 1980 - CERCLA) and other federal environmental impairment liability provisions have been interpreted to impose joint and several liability of all persons or institutions, owning or operating solid waste landfills in other disposal sites regardless of the fault of such owner or operator and the fault of the person or institution generating, transporting, or disposing of the material creating the environmental impairment; and

WHEREAS, counties and other units of local government cannot obtain environmental impairment liability insurance; and

WHEREAS, counties' continuing obligation to protect the health, safety and welfare of the local community and residents may force counties to maintain existing or create new solid waste landfills or other disposal sites; and

WHEREAS, the maintenance or creation of solid waste landfills, without appropriate insurance, under federal law as it exists today, threatens the economic stability of America's counties;

THEREFORE BE IT RESOLVED, that the National Association of Counties calls on Congress to enact legislation which will remove the strict liability provisions of the Superfund Act and other environmental impairment liability statutes, and return liability thereunder to a concept based upon fault.

BE IT FURTHER RESOLVED, that the National Association of Counties calls on Congress to enact legislation which will modify the liability provisions of the Superfund Act and other environmental legislation to be joint only, and to limit damages or other economic requirements to those elements actually caused by the party charges.

Passed by Task Force on April 1, 1986
Adopted by Board of Directors on April 2, 1986

NACo TASK FORCE
ON COUNTY LIABILITY AND INSURABILITY
PROPOSED RESOLUTION ON TORT REFORM

WHEREAS, many state legislatures have addressed tort reform and limitations on the tort liability of units of local government; and

WHEREAS, many state legislatures are currently considering tort reform and limitations on the tort liability of units of local government; and

WHEREAS, individual counties and state associations have taken and will take positions concerning tort reform and the limitation of the tort liability of counties before the legislatures and courts of the several states.

THEREFORE BE IT RESOLVED, that the National Association of Counties endorses such efforts supporting tort reform and the limitation of the tort liability of counties addressing:

- Return to a fault-based standard for liability.
- Basing causation findings on credible scientific and medical evidence and opinions.
- Elimination of joint and several liability in cases where defendants have not acted in concert.
- Limitation of non-economic damages (such as pain and suffering, mental anguish, or punitive damages) to a fair and reasonable maximum dollar amount.
- Provision for periodic (instead of lump-sum) payments of damages for future medical care or lost income.
- Reduction of awards in cases where a plaintiff can be compensated by certain collateral sources to prevent a windfall double recovery.
- Encouragement of alternative dispute resolution mechanisms to resolve cases out of court.

Passed by Task Force on April 1, 1986
Adopted by Board of Directors on April 2, 1986

NACo TASK FORCE
ON COUNTY LIABILITY AND INSURABILITY
PROPOSED RESOLUTION ON S. 2129

BE IT RESOLVED, that the National Association of Counties supports the concept of national risk retention groups for local governments as proposed by S. 2129.

Passed by Task Force on April 1, 1986.
Adopted by Board of Directors on April 2, 1986.

NACo TASK FORCE
ON COUNTY LIABILITY AND INSURABILITY
PROPOSED RESOLUTION ON S. 2046

THEREFORE BE IT RESOLVED, that National Association of Counties supports the concept of periodic payments, application of collateral source and limitation of punitive damages as contained in S. 2046 as well as the findings and purpose of the Act.

Passed the the Task Force - April 1, 1986
Adopted by Board of Directors - April 2, 1986

UNITED STATES CONFERENCE OF MAYORS
1620 EYE STREET, NORTHWEST
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LIABILITY INSURANCE REFORM
STATEMENT BY
STEPHEN CHAPPLE, GENERAL COUNSEL,
ON BEHALF OF
THE UNITED STATES CONFERENCE OF MAYORS

BEFORE THE U.S. SENATE
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

THURSDAY, MAY 15, 1986

Mr. Chairman, Members of the Subcommittee, I am Stephen Chapple, General Counsel of the United States Conference of Mayors. I am pleased today to be able to present the views of the Conference on the important issues surrounding liability reform legislation as it impacts on local governments. The current crisis in liability litigation and the availability, or unavailability, of liability insurance is falling heavily on local governments and their officials. We are encouraged that Congress is confronting these questions which raise such perilous dilemmas for those local officials who choose, apparently at great personal risk, to attempt to do the public's business at the local level.

The Conference of Mayorr will be holding its annual meeting in June in San Juan. At that time, the Mayors will address many of the issues I will discuss today — in an odd way, this crisis has come upon local governments suddenly — local governments, and their officials, were used to being responsible for everything, this new twist, large litigation costs and potential liability beyond the means of even the wealthiest of local governments, comes as a surprise. We look forward to providing you with the views of the Mayors as they adopt official Conference of Mayors policy, in June.

As you requested, I will first address the cause and scope of the crisis in liability insurance, then, I will discuss the existing problems in tort law. Finally, a short synopsis of the reform recommendations will be provided.

I. CAUSE AND SCOPE: AVAILABILITY AND AFFORDABILITY

The Conference of Mayors has recently undertaken an assessment of the insurance crisis in 40 cities. Almost without exception, the cities are reporting that they are being squeezed financially in their attempts to insure against liability in countless areas: property damage, police, fire, and errors and omissions, among them. These survey results point clearly to the need for greater national attention to these far-reaching problems.

Cities seeking to purchase liability insurance today confront major obstacles: exorbitant rate increases, annual premium increases exceeding several hundred percent coupled with reduced levels of coverage and higher deductibles, and a pool of potential carriers that is shrinking for some, and empty for others.

We are pleased to say, Mr. Chairman, that the State legislatures appear to be trying to help their local governments through this crisis. Efforts are underway in a number of States which would allow for greater pooling of risks among local governments. Finally, of course, because the insurance industry is much more subject to State regulation than federal regulation, our local governments must look first to the States for relief.

Still, cities are facing real problems. Following is a synopsis of the Conference's survey, a list of the cities surveyed is attached to this testimony.

Rate Increases: Only five of the forty cities responding indicated that their premiums for municipal coverage had not increased in the past two years. Very often, increases were dramatic. For example, one-half of the cities surveyed reported increases of over 100% for employee health and life coverage; sixteen of the forty cities reported increases in this area of coverage of over 200% in the past two years. The experiences of a few cities may help put the rate increase problem into perspective. Davenport, Iowa experienced a 3,000% increase per dollar coverage for property and general liability protection; the city reduced its coverage. Warwic, Rhode Island rejected a bid for comprehensive liability, public officials' and police professionals' coverage that called for a jump in annual premiums from $137,912 to $966,050. Warwick has adopted a mixed policy of no insurance and self-insurance in response to rate increases.

Small and large cities nationwide shared similar vignettes of premiums gone out of control. Amarillo is going bare - it chose to do so when premiums increased from $40,000 to $747,000 in two years, and the new premium only provided onetenth the coverage. These percentage increases over two years are simply more than local budgets can afford. New Castle, Pennsylvania, 400%. Santa Barbara, 500%. San Bernadino, 900%. Bellingham, Washington, 511%. Toledo, 300% in two years for one-third the coverage.

Choice of Carriers: Twenty-six (65%) cities said the selection of insurance carriers was inadequate. A sellers' market exists, officials said, where cities desiring to purchase insurance must hope, first, that a carrier is willing to provide coverage at all, and second, that the price for that coverage is reasonable. For many cities, solicitation of bids results in the receipt of a single, non-competitive bid. As Detroit reported, "All bid invitations in 1985 have resulted, in each case, in a sole bid submission. The bidders have not always been able to provide the specified limits and coverages."

Often, solicitations for bids are simply not honored; no one bids. Dayton has become "self-insured" not out of choice, but because it was unable to find an insurer willing to offer coverage.

The explanations for these dismal facts are not easy to find or to state. Surely, the insurance industry's change from investment underwriting, anticipating the ability to pay claims out of the proceeds of invested premiums in times of

high interest rates, to actuarial, risk-based coverage, is a contributing factor. In its rush for premium dollars to invest in the high interest days of the late 1970s and early 1980s, the industry seemed to forget that, in fact, the risks insured against do happen, that people slip and fall, that police and fire vehicles sometimes have accidents, that sometimes, public officials make improper decisions for which they and their jurisdiction may be held liable. Unfortunately, as was predictable, the claims keep coming; the interest rates, as was predictable, were unpredictable and the income to pay the claims simply was not there. A natural result of this dicotomy is premium increases, large increases, for reduced coverage.

II. EXISTING PROBLEMS IN TORT LAW

There has clearly been a shift in tort law, away from "fault" based liability to compensation-based "no-fault" liability. This shift surely seeks a noble result, the compensation of the faultless to allow them again to become full, participating members of society. Unfortunately, on the way to the noble result, a number of truly unfortunate things happen.

Governments, particularly local governments like cities and counties, are the real "deep-pocket" defendants. Unlike private businesses which can sell off assets and then seek the protections of the Federal Bankruptcy Code, local governments have to stay in business. Bankruptcy for them consists of fairly minor reorganizations which, for a while, divert tax dollars to specific creditors. The sewage still needs to be treated, the police need to work the beat, fires must be suppressed, and the garbage must still be hauled. Somehow, the tax base of a community gives the appearance of being an endless well - e.g., the deepest pocket.

Two major consequences ensue from the availability of this endless well. The current rules on joint and several liability, allowing the injured party to recover all of the damages from any tortfeasor regardless of the degree of fault, makes local governments, their treasuries and tax bases, very attractive defendants. Plaintiffs' lawyers have every good reason to try to implicate a governmental agency as a defendant in any suit; consequently, our cities find themselves on the wrong side of the "vs." much too often. These rules should be reconsidered.

Second, cities and counties are the deepest pockets of all. They pay, through the public welfare system, for all of the injuries and hurts not covered by private companies or insurance. Governments are the insurers of the last resort. How else to explain the "dumping" of poor patients on public hospitals. If the homeless find shelter at all, it is found at the expense of government. In redesigning the tort system, some consideration should be given to the role that local governments play as providers to society; a tort system that recompenses the few at the expense of the many, may not be appropriate, some of its rules might not quite fit, when applied to institutions designed to take care of the many. How many police officers or fire fighters or welfare workers could a city hire with the money used to pay a single million dollar verdict plus transaction costs?

Transaction costs. Suits against cities are undoubtedly more complex than they used to be. It is not unusual to find pleadings against cities which seek relief under numerous theories. This includes Federal theories on antitrust, civil rights, violations of environmental or other laws, and others. It also includes state law based theories, torts, contract, state antitrust, violation of "good government" laws such as sunshine meeting or open records laws. Since governments are the deepest pockets of all, it is very much in the interest of parties to use every theory imaginable to attempt to impose liability on local governments. Because they are governments, and they have the power of government, the Federal and State Constitutions impose specific and important duties, regarding fairness and equal protection and public service, on all local governments. These duties cannot and should not be forgotten or ignored. Any clarification of these duties, a simplification of the rules, will serve two purposes. It will make it easier for local governments to conform to the law, and it will reduce the transaction costs associated with liability litigation.

III. REFORM RECOMMENDATIONS

Mr. Chairman, our recommendations are, at the moment, tentative. The Conference of Mayors will be developing comprehensive policy on these issues in June; we as staff, need the guidance of our Mayor members.

First, we are convinced that most of the answers lie at the State level. Tort law is a creature of the fifty States. Our cities are working with the States at reform.

There is, however, room for a Federal response to these problems. This response could include the following:

- o Federal data gathering - There are many data-specific and anecdotal details about the various "winners" and "losers" in the current liability insurance situation. Yet, depending on whom you talk to, those parties change — lawyers, insurers, purchasers — as do the causes of the condition — the economy, the courts, the law. The Federal government can help us to undertake an impartial, comprehensive examination of the facts that would justify and support the reforms we seek.
- o Review of the McCarran-Ferguson Act, 15 U.S.C. §§1011 - 1015 - Since the adoption of this Act in 1945, the States have exclusively regulated insurance activities within their borders. Numerous "hard" and "soft" cycles have occurred, with the most recent "hard" cycle causing serious, perhaps irreparable disruption and raising questions about the States' ability to continue effectively to manage insurance activities. Even if a State came up with a perfect system of law applicable to local governments, it appears that the insurance industry, writing policies on a national basis, would not be responsive. This dilemma warrants Federal review and oversight.

- o Federal monitoring of the insurance industry - As insurance related issues continue to emerge and continue to cross state lines, thereby affecting the national population, Federal oversight is needed.
- o Assistance in inter- and intra-state pooling has been recommended in recent Senate bills. Removal of prohibitions against risk pooling by local governments within and across state lines responds to one of the current insurance barriers cities face.
- o Tort reform in conjunction with the recommendations above - this may include caps on legal fees and non-economic damages. The availability of structured settlements would go a long way toward protecting local governments from devastating liabilities. Joint and several liability rules which recognize the degree

of fault of each actor would spare local governments from many a suit and many settlements designed to reach into their deep pocket. The collateral source rules should recognize that local governments are the final "collateral source," and that they should not be required to reach into the same pocket twice to care for injured persons.

From the States we ask continued diligence in pursuing new legislative strategies including assistance in pooling efforts by local governments and prevention of mid-term cancellations and similar, often unwarranted, actions.

Mr. Chairman, the U.S. Conference of Mayors would be most pleased to work with this Subcommittee as you continue to explore options for dealing with this very serious issue. We will comment on the specifics of the three legislative proposals, S.2038, S. 2046 and S.2129, during our testimony.

Thank you for this opportunity to appear before you today.

APPENDIX

U.S. CONFERENCE OF MAYORS

SURVEY RESPONDENTS

City	Population	City	Population
Akron, OH	237,177	Mayaguez, PR	100,634
Amarillo, TX	165,000	Midland, TX	95,000
Bayonne, NJ	65,049	Midwest City, OK	59,000
Bellflower, CA	56,347	Monroe, LA	57,000
Bellingham, WA	47,500	New Castle, PA	33,500
Castle Rock, CO	7,000	Newton, MA	85,500
Chandler, AZ	57,000	Norfolk, VA	279,800
Columbus, OH	570,588	Orlando, FL	134,000
Davenport, IA	103,799	Park Forest, IL	26,222
Dayton, OH	190,000	Quincy, MA	85,000
Denver, CO	485,000	San Bernadino, CA	130,000
Detroit, MI	1,203,339	San Leandro, CA	65,000
East Chicago, IN	39,000	San Rafael, CA	44,700
Grand Forks, ND	43,765	Santa Barbara, CA	75,000
Greenwich, CT	59,578	Savannah, GA	150,000
Highland Park, MI	27,909	Shaker Heights, OH	31,000
Indianapolis, IN	760,000	Somerville, MA	80,000
Joliet, IL	77,956	Toledo, OH	345,000
Knoxville, TN	175,045	Tulsa, OK	360,000
Maple Heights, OH	29,735	Warwick, RI	90,000

Municipal Liability Concerns

A 145 City Survey

JULY 1986

UNITED STATES
CONFERENCE OF MAYORS

UNITED STATES CONFERENCE OF MAYORS

Joseph P. Riley, Jr.
Mayor of Charleston, S.C.
President

Richard L. Berkley
Mayor of Kansas City, MO
Vice President

Arthur J. Holland
Mayor of Trenton
Chairman, Advisory Board

John J. Gunther
Executive Director

This report was written by Deborah Lamm and Richard D. Johnson of the U.S. Conference of Mayors staff.

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BACKGROUND

This document summarizes city responses to a United States Conference of Mayors questionnaire concerning the impact, causes and possible solutions for the nation's liability insurance crisis. It represents the second Conference effort to collect information about the liability insurance situation and its meaning for cities.

Late in the summer of 1985 the Conference of Mayors surveyed a small sample of cities to determine the extent to which the availability and affordability of liability insurance posed problems for local governments. The survey demonstrated that liability insurance was most assuredly a problem for almost every city.

To further explore this issue, Mayors exchanged views in January 1986 with a panel whose members included a United States Senator and representatives of insurers, consumers, and the Administration.

Following up, last March the Conference asked a number of local government leaders to share their perceptions and recommendations relating to resolution of the problem. One hundred and forty five cities responded, describing their difficulties in purchasing or identifying available insurance against liability, the legal challenges encountered regarding questions of municipal liability, and options for solving cities' liability concerns. These recent data again confirm the breadth and continued severity of the problem.

EXECUTIVE SUMMARY

Almost all of the 145 cities responding to the United States Conference of Mayors liability insurance update report serious problems in obtaining and paying for liability insurance. As a consequence of rising insurance costs, cities have been forced to cut back on insurance coverage. Unwilling to accept risks for which they are uninsured, some cites are now cutting back on municipal services and programs for which liability insurance is inadequate or unavailable. Although short of unanimity on the questions of causes and solutions, cities are agreed liability insurance is a pervasive problem demanding immediate action.

Major survey findings are in the following areas:

Impact

- Service cuts were the most frequently reported result of cities' liability problems, with 15 percent of cities indicating services have been cut or curtailed. Absent changes, the majority of respondents forsee the need to cut services in the future.
- Tax increases and public officials' resignations have taken place in a small minority of cities.

Causes

- Asked to identify major factors behind the liability insurance crisis, most respondents pointed to the legal tort system, which results in high awards, and to the mismanagement of the insurance industry.
- Other causes often identified were failure of the legal system to uphold the principle of sovereign immunity, and a prevailing attitude among the citizenry that someone is at fault for all accidents, the "sue syndrome."

Policy Coverage

- Self insurance is widely accepted by cities. For some, this route is a deliberate one. For others, it is a passive choice dictated by the absence of options. For still others, self insurance is in fact no insurance, but a term which signifies the set-aside of a small portion of a city's budget to be used for liability costs that might arise. In many of these cases, the set aside falls far short of potential costs.
- Twelve percent (18) of the cities report they are "bare" and are operating with no insurance for one or more areas of liability.

Legal Considerations

- Since 1981, 79 percent (115) of cities have faced a liability suit brought under Section 1983 of the Civil Rights Act.

- The majority of liability cases are settled before reaching trial; 30 cities (20.7 percent) have had no liability cases decided by the courts since 1981.
- The most significant financial impact of municipal liability cases occurs at the claims or settlement stage, not at the judgement stage.

Solutions

- Survey respondents suggested tort reform in combination with management and legislative reform as a means of addressing their liability insurance concerns. Specific areas most respondents agreed need change were: reduction of joint and several liability; capping awards and attorneys' fees; and, amending Section 1983 of the Civil Rights Act to limit local governments' vulnerability to liability claims. Secondary recommendations stressed strengthening the federal government's role in insurance regulation through steps including: amending or repealing the McCarran-Ferguson Act; initiating federal data collection; and facilitating inter- and intra-state pooling.
- Little support appears for a laissez-faire approach. Only one city cautions, "Don't start regulating as we deregulate."

POLICY COVERAGE

More than one-half of the cities surveyed said they self-insure for at least a portion of comprehensive general and police-professionals; they purchase insurance against property liability.

LIABILITY POLICY COVERAGE

total=145 cities*

	Comprehensive General	Police-Professionals	Property	Other
Self Insured	81	70	42	51
Private	48	55	102	54
Pool	19	14	12	10
Combination	14	9	17	11
Other	3	0	1	5
None	7	17	1	2

* totals do not equal 145 as categories are not mutually exclusive

This pattern holds true for almost all size cities except those under 100,000, where, for comprehensive general insurance, about 30 percent report they self insure, 30 percent use private insurance, 15 percent pool and 25 percent use a combination of options. Private insurance is purchased for police coverage in approximately 30 percent of cities with populations below 100,000 and for property coverage in about 50 percent of the cases.

Eighteen cities indicated that they are going bare for one or more policies. These cities, ranging in size from Memphis (646,356) to Richardson, TX (72,496) and Highland Park, MI (27,909), lack insurance against liability in areas such as: general comprehensive, police-professionals, and property.

- East Brunswick, NJ was forced to cancel its public officials insurance when costs for this line of insurance rose to the equivalent of 3.75 tax points.

- St. Louis, which has no insurance for general comprehensive, police-professionals and property, wrote about its policy to handle liability insurance claims without any insurance, "our operation has been a model for other local governments which have abandoned insurance because of the escalating premiums..."

- Rochester, MN determined to go bare for public officials coverage when the only coverage available rose nearly 600 percent from the previous year.

CITIES REPORTING NO COVERAGE FOR ONE OR MORE POLICIES

City	State	Population	Policy
Alameda	CA	63,852	General Comprehensive
East Brunswick	NJ	37,928	Other
Erie	PA	118,493	General Comprehensive
Evansville	IN	130,275	Police-Professionals
Flint	MI	154,019	General Comp./Police-Professionals
Harlingen	TX	43,543	Other
Hawthorne	CA	56,477	General Comprehensive
Highland Park	MI	27,909	Police-Professionals
Kansas City	MO	443,075	Police-Professionals
Mankato	MN	28,651	Police-Professionals
Memphis	TN	646,356	Police-Professionals
Mosdesto	CA	114,076	General Comp./Police-Professionals
Redondo Beach	CA	57,102	Police-Professionals
Richardson	TX	72,496	General Comprehensive
Rochester	MN	57,855	Police-Professionals
San Juan	PR	522,700	Police-Professionals
South Bend	IN	107,690	Police-Professionals
St. Louis	MO	437,354	General Comp./Police-Professionals/ Property

LEGAL CONSIDERATIONS

The intent and design of liability insurance is, of course, to provide protection against legal action that might be taken against the insured. For cities, these legal considerations have begun to center recently in the federal court system as civil rights laws have been broadly interpreted to apply to liability cases.

The Civil Rights Act (42 U.S.C. 1983)

As evidenced by the Conference's questionnaire, the delicate issue of amending the Civil Rights Act, the nation's premier civil rights law, is something local government officials may have cause to weigh seriously. Seventy-nine percent of the survey cities said they had been sued for liability under Section 1983 of the Civil Rights Act at least once since 1981; all nine cities with populations between 500,000 and one million had been sued in this manner.

Section 1983 of the Civil Rights Act, originally part of the Ku Klux Klan Act, was enacted in 1871 in the wake of the Civil War as a means of safeguarding the newly affirmed rights of many Americans. In the 115 years since, this legislation has been untouched and unchanged. The law is held in such high regard that until recently the very notion of altering it in any way, no matter for what purpose, would be been rejected as out of hand.

However, in 1978, in a landmark case, Monell v Department of Social Services of the State of New York, the U.S. Supreme Court held that a municipality could be treated as a person under Section 1983 of the Civil Rights Act and therefore, both the municipality and its employees could be sued for actions taken by officials acting on the municipality's behalf. In the short time following this decision, thousands of civil rights suits dealing with issues of municipal liability have been filed against municipalities in federal courts each year.

The increasing number of municipal liability claims based on the Monell decision has led some to reevaluate the notion that Section 1983 is set in stone. Not only does the ever increasing liability activity obviate the law's true intent, it is suggested the presence of so many liability suits based on civil rights principles ties up an already overburdened court system, thus preventing legitimate civil rights cases from being heard. Others, who continue to regard Section 1983 as sacrosanct, are unmoved, fearing that tampering with this landmark legislation could open a Pandora's Box, ultimately compromising the essential freedoms guaranteed under the law while ameliorating only marginally a major flaw in the federal court system.

Levels of Federal and State Legal Action

Asked about the level of legal activity since 1981 in federal and state courts, 115 cities said they had had a total of 2583 cases tried in federal courts and 3033 cases in state court. This amounts to an average of 22.5 cases per city in federal court and 26.4 cases per city in state court over a period of 4 1/2 years.

A large judgement may result in costly consequences. Chester, PA, for example, with an annual budget of slightly more than 15 million dollars, experienced three judgements against it over the past four years, totalling 4.5 million dollars. This translates to liability costs in judgements alone approaching 8 percent of the city's four year budget.

Sizable as the above judgements are, they do not accurately reflect the huge liability claims cities have experienced. As officials in Milwaukee wrote, "The majority of cases against a municipality are settled at the claims stage before there is a lawsuit or during the lawsuit stage before there is a judgement." For this city, which does not distinguish between payments made at the claims stage, lawsuit stage or at the judgement stage, since 1981 2,025 claims were paid, "some of which became lawsuits and only a few of which became judgements. The total amount paid was $3,922,823."

- Newark reports $26.7 million in claims paid since 1981.
- Thousand Oaks, CA was found liable for three judgements since 1981, with payments totalling five thousand dollars. However, this city wrote, "most of our claims are settled." Inclusion of settlement costs for this period raises costs for liability claims by 5,900 percent to a total of three hundred thousand dollars.
- Newton, MA reports a single judgement since 1981 at a cost of five thousand dollars. The inclusion of settlements, however, raises the claims figure to over one million dollars, an increase of 19,900 percent.

Although 30 cities reported no suits reaching either federal or state court since 1981, settlement costs were paid by almost all of these cities. For Euclid, OH, which had no judgements against it in the four and one half year period, settlement costs amounted to 47 thousand dollars.

CAUSES

The perceived causes of the current municipal liability situation are varied: no one factor is viewed by city officials as the dominating force causing carriers to discontinue their insurance, or to price insurance beyond the cities' ability to pay. No one cause was common to all 145 cities responding to the questionnaire, though two causes came close to a 50 percent response rate. City size seems to have no influence on the responses provided in this category.

In general, city officials feel that there are four major factors behind the current crisis:

- excessive awards by juries (49 percent).
- mismanagement of the insurance industry in recent years (42.8 percent), when interest rates were sharply higher than they are at present.
- the "sue syndrome" (20 percent).
- the contingent fee system for attorneys taking liability cases (17 percent).

CAUSES

	Insurance Industry Mismangement	Contingency Fee Structure*	High Awards	"Sue Syndrome"	Reinsurance Market	Other
Under 100,000 (77)	28	9	32	18	4	32
100,000-250,000 (42)	24	11	26	8	1	21
250,000-500,000 (15)	7	5	7	1	1	4
500,000-1,000,000 (9)	2	0	5	2	1	5
Over 1,000,000 (2)	1	0	1	1	0	2
All Cities (145)	62	25	71	30	7	64

* and other causes related to attorneys

High Awards

Forty-nine percent of cities responding to the questionnaire suggest that high jury awards are a major contributing factor to the present liability situation. Respondents see several factors combining to produce this situation:

- Uninformed Public. Several cities noted that jury members are ill informed concerning who actually pays the large amounts awarded for "pain and suffering." Respondents felt that jurors are often unaware that exorbitant judgements are ultimately paid by their own taxdollars.
- Joint and Several Liability. Seventeen cities (11.7 percent) mentioned the doctrine of joint and several liability as problemmatic. Under joint and several liability tort provisions, cases may involve multiple defendants where each may be judged fully liable for the total judgement, even if a particular defendant was only negligent to a small degree.
- Deep Pocket Syndrome. Twenty-two cities (15.2 percent) specifically mentioned "deep pocket" as a major cause of the liability crisis. Closely associated with the notion of joint and several liability, "deep pocket" refers to judgements awarded to claimants based more on the misconception that a municipal government has unlimited resources than on the comparative responsibility of the city to pay its fair share of the judgement. In other words, if a city-financed contractor is sued (and the city is also sued under joint and several liability), judgements are often made against the city, rather than soley against the contractor, based on the misperception of the city's ability to pay.

Mismanagement of the Insurance Industry

Nearly half (42.8 percent) of cities responding to the questionnaire place major blame on the insurance industry for the current liability situation. While some cities see the problem due to "avarice and greed by insurance companies, attorneys and litigants" (Artesia, CA); due to "greed of insurance companies who enter the market on 'soft' cycle times and withdraw when it gets hard" (Oak Park, MI); or that "this 'crisis' has been orchestrated by the insurance industry" (Harlingen, TX), most cities faulting the insurance industry believe that mismanagement is the major cause. A common analysis was submitted by Virginia Beach:

> "One cause is five years of cash flow underwriting by insurance companies who wrote virtually any risk at insufficient premiums solely for the purpose of investing premium funds to obtain high interest returns." [Now that interest rates are lower] "funds are not available to the insurers in sufficient amounts to pay claims that occurred during the low premium policy years. Therefore, selective underwriting and dramatic premium increases are required in order to keep the insurers solvent."

Several respondents, including officials from Fullerton, CA, Roanoke, VA, and Shaker Heights, OH, also mentioned the insurance industry practice of "redlining" municipal governments and not evaluating individual past performance when determining the rate at which premiums will be charged.

Public Attitude

One-fifth of all cities surveyed attributed part of the cause of the current liability crisis to a growing public attitude that for every unfortunate loss or accident in life, someone else is at fault. This "sue syndrome," as it is termed by a Columbus, GA official, results in an increasing number of frivolous suits, often for large amounts. In the case of a frivolous suit, the alternatives for a city are two: (1) take the suit to court where judgement will likely be made in favor of the city, but attorney's fees will have to be paid for defense; or (2) settle out of court for a lesser amount. In either case, the city experiences costs as a result of the "sue syndrome."

Lawyers and Contingency Fees

Officials in twenty-five cities (17.2 percent) cited attorneys or the contingency fee structure as a major cause of the liability crisis. Contingency fees are seen as inviting litigation, since it costs the litigant nothing to bring suit against the city, again raising the number of frivolous suits that the city must either defend against or settle out of court. Virginia Beach and other cities see the problem going beyond the contingency fee structure: "Plaintiffs' attorneys accept virtually any case brought to them, and have been successful in delaying resolution of any claims until the insurers become willing to pay exorbitant settlements in order to avoid further exorbitant legal fees." The sentiments of officials in Aurora, CO were echoed by officials in Thousand Oaks, CA who wrote that part of the problem stems from "too many lawyers in search of a limited number of legitimate factual situations justifying litigation." The risk officer in Dunedin, FL feels "attorneys, through advertising, are encouraging more and more litigation."

Other Causes

Forty-four percent of cities noted other causes of the liability situation. These include:

- Erosion of Immunity. Kettering, OH; Orange Township, NJ; Anaheim, CA; Irvine, CA; and Lansing, MI note that governmental immunity has been eroded over the past few years;
- Pain and Suffering. Jacksonville and others see costs rising because of high jury awards for "pain and suffering," beyond the costs of actual damage.
- Reinsurance Market. Cheyenne; Paducah, KY; Knoxville; Plainfield, NJ; Newark; Wilmington, DE and San Juan believe the poor reinsurance market is a major contributing cause.

- Insurance Market Regulation. Portland, OR and Dallas find inadequate regulation of insurance companies at fault for the current situation.
- New Types of Claims. Officials in Greenville, NC; Louisville and Morristown, NJ view new types of claims for which cities are made liable, including hazardous waste dumping and pollution of the air and water, as one of the major factors causing the liability crisis.

IMPACT ON CITIES

That costs for city liability insurance are increasing, when it is even available, is an undeniable fact. As is the case in Garland, TX, it is not uncommon for costs to have tripled in recent years while coverage is reduced.

Though the costs of insurance are rising for all cities not currently self insured, the effects on local government have not been felt uniformly among cities. On the one hand, a city such as Hayward, CA, though "just beginning to feel the terrible effects of the liability insurance situation," believes that the "entire asset structure of the city is threatened." Members of voluntary commissions have resigned, the city is contracting out services it might otherwise perform, and additional self-insurance funds must be set aside, eliminating the availabilty of this money for other city uses. Equally alarming is the case of Plainfield, NJ, where substantial increases in insurance premiums for the current year have forced the layoff of approximately 11 percent of the city work force, 60 employees out of a total of 550. On the other hand, recent increases for liability coverage have not been a problem for cities such as Nashville, which has been self-insured for eight years. For most localities, however, the impact of rising liability insurance costs has been somewhere between these two extremes.

In coping with this situation, there are few options open to city government:

- money must be taken from existing programs and services to pay insurance companies for more limited coverage;
- money must be taken from existing programs to set up a city liability fund if no insurance carriers are willing to accept the city as a risk;
- money must be taken from existing programs and services to place in a self insuring "pool" with other local governments, where legally feasible;
- new moneys must be raised through increased local taxation (sale or property tax) to compensate for funds lost to continue coverage; or
- a city may "go bare" and operate without insurance.

Eighty percent of those responding to the questionnaire indicated that increasing liability insurance costs are having some negative impact in their city. Most often, these responses fall into the following catagories: services cancelled or curtailed; services contracted out; resignations of public officials; and transfer of funds/budgeting problems.

IMPACT ON CITIES

	Services Curtailed	Services Cancelled	Services Contracted Out	Waivers/ Releases	Resigna- tions	Other
Under 100,000 (77)	5	9	4	5	1	45
100,000- 250,000 (42)	2	3	1	9	0	25
250,000- 500,000 (15)	1	1	0	0	0	9
500,000- 1,000,000 (9)	1	0	0	1	1	4
Over 1,000,000 (2)	0	0	0	0	0	2
All Cities (145)	9	13	5	15	2	85

Resignations

Resignations, perhaps the most dramatic illustrations of the present liability situation, have resulted from public officials' fears of being personally sued for decisions necessitated by their office. Given the erosion of immunity and the increasingly litigious attitude of the public, many officers of governement accurately perceive themselves to be at increased personal financial risk. Fortunately, this situation has not yet led to widespread resignations: of the 145 cities surveyed, only Hayward, CA and Memphis reported that public officials had resigned in response to concern over personal liability for the city's actions.

Difficult to ascertain but surely significant are the numbers of well qualified persons chosing not to enter public service because of increased personal risk. Lubbock, TX and Anchorage, for example, reported that officials were considering resignation or that various Board or Authority members are evidencing reluctance to serve. In Baltimore, public officials insurance has been cancelled and members of Boards and Commissions are more wary of their exposure, though the situation has not yet resulted in resignations. Another situation difficult to quantify was reported by New Orleans, where some administrators and supervisors are reluctant to discipline employees for fear of being sued.

Service Cancellation or Curtailment

The most common effect of the current liability situation has been in the area of service cancellation or cutbacks. Nearly one-sixth (15.2 percent) of the cities surveyed indicated that specific city services had been terminated or curtailed. Most often effected were recreation programs.

Erie, PA has had to suspend operation of its city recreation program Rochester, MN has cancelled two recreation programs, while in Wyandotte, MI, rising insurance costs were the cause of closing a children's recreation park. Similarly, in response to insurance premium increases from $82,000 to $480,000, Redondo Beach, CA was forced to cancel some events at the community swimming pool, and in Parkersburg, WV, several recreation programs were halted as a result of the rising costs of liability insurance.

While city recreation programs are often the first target, limitations on city programs and services are not confined to this area. For example, police departments in Sacramento and Fresno were forced to discontinue citizen "ride-along" programs, a valuable community relations effort through which the public learns much about what police work entails while the police force is brought into closer contact with the community it serves.

Several cities responding to the questionnaire indicated that, although no specific programs had been affected yet, the city has accepted as inevitable that services will suffer in the near future. Fresno and Kokomo are both currently evaluating what services can be reduced or eliminated, and in Toledo and Flint several activites are being reviewed for loss exposure, especially recreation programs.

Nor are city-run programs the only projects affected. Because of the difficulty of obtaining insurance, numerous community activities planned by non-profit groups in Clearwater, FL and Knoxville have been cancelled. In Alameda, CA those wishing to use city streets for walk-a-thons or other fund-raising events have been unable to meet insurance requirements, forcing cancellation of proposed activities.

Beyond specific programs being targeted for cancellation or curtailment, a much more common experience of the cities is reduction in available city general funds, such as in Spokane; Oak Park, IL; Portland, OR; Anaheim and Santa Barbara. Elizabeth, NJ and Buena Park, CA also report that increased costs for insurance are necessitating the transfer of public money from the general city fund to their liability fund. In Syracuse set aside funds to cover possible liability suits have take $1.6 million out of the city budget, while Thousand Oaks, CA reports that the increased costs of insurance might otherwise have been spent for roads and parks. Several cities, including Ann Arbor and Greenville, NC, note that "due to the volatile nature of the insurance industry," planning the budget process itself is made much more difficult. Further, Akron reports that the burden on city administrative staff is increased due to additional requirements of obtaining waivers and releases from contractors.

Contracting Of Services

Not all local government services are actually performed by city employees. Some services, such as refuse collection and ambulance services, have been found more cost effective when contracted out to private companies. In South Bend, however, liability concerns are delaying the planned privatization of some services. Other cities, including Dallas, Minneapolis, Pittsburgh, Shaker Heights, Santa Monica, and San Juan report that it is becoming increasingly more difficult for contractors to obtain necessary insurance at a price that will allow them to continue providing services. In Chicago, officials observe that the trend is hardest on small and minority contractors, who "find it nearly impossible" to obtain insurance, reducing competition among firms that are able to bid on providing services.

Taxes

To offset the shortfall in city funds due to an increase in liability insurance costs, five cities report that they have either raised taxes or are considering doing so. Dayton has already raised its taxes to compensate for its increasing insurance costs and the city of Manatowac, WI must raise the property tax to cover a $100,000 increase in insurance premiums. Similarly, Des Moines reports that the cost of significant claims will be shifted to taxpayers through the property tax. Bloomington, IL and Cheyenne, WY officials also see the possibility of future tax increases.

SOLUTIONS

Nearly all (98.6 percent) cities responding to the questionnaire recommended some solutions to current the municipal liability insurance crisis. Recognizing that there is no one solution or "quick fix" to this problem, the vast majority of cities suggested a number of avenues of reform whose combined efforts could lessen the severity of the situation. This underlying complexity is revealed by the number of options that cities are willing to explore: 61 percent of respondents recommended at least ten areas of reform, 86 percent recommended at least six options, and 98 percent suggested at least three possible solutions.

In addition to the possible solutions offered by the questionnaire (see Appendix C), 46 percent of cities responding suggested additional areas of reform for consideration. Only two cities gave no response to this section of the questionnaire.

For the purposes of the questionnaire, possible contributing solutions were grouped into four categories: state tort solutions, federal tort solutions, other state solutions, and other federal solutions. All options concerning state and federal tort law presented by the questionnaire were viewed favorably by a majority of cities. Though, in general, cities place greater importance on amending state tort law, city officials also believe federal reform a path worth exploring.

State Tort Solutions

Ninety-six percent (139) of respondents felt that possible solutions to the municipal liability situation could be found in the area of state tort reform. As mentioned previously, however, state tort reform alone is not viewed as a panacea for the liability crisis. Dallas, for example, pointed out that although tort reform in nearly all the areas addressed by the questionnaire is needed, "the overhaul of the tort system will not necessarily result in [the future] availability of liability insurance."

STATE TORT SOLUTIONS

	Amend Joint & Sev. Liability	Cap Awards	Cap Attorneys' Fees	Structured Settlements	Other
Under 100,000 (77)	64	64	57	47	19
100,000-250,000 (42)	39	34	38	30	17
250,000-500,000 (15)	13	12	11	9	6
500,000-1,000,000 (9)	6	7	6	5	3
Over 1,000,000 (2)	2	1	0	2	2
All Cities (145)	124	118	112	93	47

Of those expressing a need for tort reform at the state level, 88 percent would amend joint and several liability provisions to allow for a more fair distribution of liability based on actual responsibility. One hundred seventeen cities suggested a cap on the dollar amount for judgements awarded under tort liability. Most often mentioned in this regard is a cap on non-economic damage, or "pain and suffering." One hundred twelve cities also felt that a cap on attorney fees or removal of the contingency fee structure would help to reduce the number of claims filed against cities.

Sixty-four percent of all cities surveyed favored the option of structured settlements under state tort law. This type of settlement, limited primarily to cases involving major injury or death, allows for payments during the course of several years to cover continuing housing, food or health care expenses of an injured person, rather than a lump-sum payment.

Nearly one-third of respondents recommended other areas of state tort reform. Several cities, including Pittsburgh, San Juan, and Dayton called for the strengthening of governmental immunity statutes. To reduce the number of frivolous suits, Charlotte, NC; Sunnyvale, CA and other cities suggested the institution of the "English Rule" of requiring the losing party to pay all court costs, including attorneys' fees. Other cities, such as Greenville, NC and Fullerton, CA, favor the elimination of punitive damages; i.e., monetary awards above the cost of actual damages.

Other State Solutions

Outside of state tort law reform, 90 cities (62 percent) call for the prohibition of mid-term policy cancellations by liability insurance carriers and 86 cities recommend state-level actions to facilitate intrastate pooling among municipalities. Fifteen percent of cities suggested other areas of state-level involvement, including:

- requiring insurance premiums to be based on past municipal experience (Lincoln; Newton, MA; Shaker Heights, OH; Syracuse; Winston-Salem).
- data gathering (Arlington, TX).
- strengthening the state regulation of insurance companies (Louisville).
- establishing a separate risk classification for municipalities (Syracuse).
- establishing a state development fund to insure municipalities (Buena Park, CA).

OTHER STATE SOLUTIONS

	Prohibit Mid-term Cancellations	Facilitate Intra-state Pooling	Other
Under 100,000 (77)	46	51	7
100,000-250,000 (42)	29	24	10
250,000-500,000 (15)	10	7	3
500,000-1,000,000 (9)	5	3	2
Over 1,000,000 (2)	1	2	0
All Cities (145)	91	87	22

Federal Tort Solutions

One hundred thirty-five cities (93 percent) indicated that changes in federal tort law would help alleviate the current liability crisis. Most often mentioned as an area of possible federal reform was capping judgement awards (78.6 percent), followed closely by capping attorney fees (75.2 percent). Two-thirds of cities responding to the questionnaire called for amending the practice of joint and several liability.

FEDERAL TORT SOLUTIONS

	Amend Joint & Several Liability	Cap Awards	Cap Attorneys' Fees	Structured Settlements	Other
Under 100,000 (77)	57	59	53	41	12
100,000-250,000 (42)	28	35	36	28	13
250,000-500,000 (15)	9	12	13	9	7
500,000-1,000,000 (9)	3	8	8	6	3
Over 1,000,000 (2)	1	1	0	1	0
All Cities (145)	98	115	110	85	35

Other Federal Solutions

The severity of the current crisis is evidenced by the willingness of city officials to consider changes in the Civil Rights Act. More than two-thirds of the cities called for amendments to Section 1983 of the Civil Rights Act. Cities also suggested reform of Section 1988 of the Civil Rights Act, affecting attorneys' fees in civil rights cases. Among those calling for Section 1988 reform were officials in Bloomington, IL; Greenville, NC; Harlingen, TX; Hayward, CA; Newton, MA and Oklahoma City, OK.

In addition to tort reform and amendments to the Civil Rights Act, 113 cities (77.9 percent) responded that there is a need in for federal actions in other areas. Fully 40 percent of cities feel that the federal government needs to gather accurate data on the liability situation. Further, over one-third of cities call on the federal government to increase oversight of the insurance industry.

Sixty-two cities recommend federal facilitation of interstate pooling of municipal liability insurance and 51 favor the establishment of a federal reinsurance fund. Galveston, TX notes in its response that "federal reinsurance could be used as it is in the National Flood Insurance program in dealing with large catastrophic windstorm losses."

OTHER FEDERAL SOLUTIONS

	Data Gathering	Over-sight	Facilitate Inter-state Pooling	Repeal/Amend McCarran Ferguson Act	Federal Rein-surance Fund	Amend U.S.C. 42 Section 1983	Other
Under 100,000 (77)	26	29	38	12	25	53	4
100,000-250,000 (42)	20	14	15	6	16	31	5
250,000-500,000 (15)	8	6	6	4	4	10	1
500,000-1,000,000 (9)	5	4	2	2	5	6	1
Over 1,000,000 (2)	1	1	2	0	2	0	0
All Cities (145)	60	54	63	24	52	100	11

SOVEREIGN IMMUNITY DOCTRINE

Senator HECHT. Thank you very much. Let me go right along with questions here.

Mr. Chapple, in your testimony, you mentioned that the current rules on joint and several liability make local governments or their treasuries and tax bases very attractive to defendants.

Would you advocate the reinstatement of sovereign immunity as an appropriate solution?

Mr. CHAPPLE. It seems that the reimposition of sovereign immunity isn't really going to work. What's really needed is a coordinated response between the Federal Government and the State governments to come up with a compensation system that makes sense.

In fact, if people get injured, it's probably somebody's duty, and it will finally be the government's duty through the public hospital in any event to find a way to compensate the injured person.

One of the problems with the sovereign immunity doctrine is the interjurisdictional problem, so that even if a State comes up with a compensation statute that makes sense, that deters wrongdoing and compensates victims, the system will not work as against the Federal laws.

So if the city is operating in such a way that there's a section 1983 civil rights case against it, State sovereign immunity will not apply.

So the interjurisdictional problem I think is as complicated as coming up with a compensation based system that makes sense.

Senator HECHT. You advocate a review of the McCarran-Ferguson Act, which gives States the right to regulate the insurance industry, because premiums have an inverse relationship to interest rates that are set on a national level. Would you advocate oversight of the insurance industry by the Federal Government, or that Congress merely take steps to soften the wide swings in premium rates?

Mr. CHAPPLE. The value of the McCarran-Ferguson Act, or the value of the the antitrust laws, is that finally it makes the industries that are regulated have to look over their shoulders all the time. If there were a Federal role, if there was Federal oversight of the insurance industry, that would probably help the industry level out these swings in premiums, and also that review would make it easier for well-meaning State legislatures who are trying to help their local governments.

Senator HECHT. Thank you.

Mr. Ruck, in the National Association of Counties' proposed resolution on the Civil Rights Act of 1871, you call upon Congress to enact legislation establishing an alternative dispute resolution process consistent with that in S. 2038.

How would this lower transaction costs?

ARBITRATION IS LESS EXPENSIVE

That is, do you believe that establishing an arbitration panel will ultimately be less expensive than pursuing actions through the courts?

Mr. Ruck. After 20 years of an active legal practice, I am convinced that anything is less expensive than ultimately taking every matter fully through the courts.

Senator Hecht. Having 35 years in business, I agree with you.

Mr. Ruck. Senator, there might be a number of methods of using the alternate dispute resolution in the arena of civil rights. One may be subject to take a page from the EEOC and have some type of Federal or State agency review complaint analysis for administrative relief.

Another method could be an opportunity for nonbinding arbitration or mediation. At this point, NACo has no desire to try to suggest alternative dispute resolution in any specific form. But we would like to explore as many avenues as could reasonably be created. Transaction costs always go down if you reduce the number of participants and if you reduce the time of all participants.

And in every area, civil rights commercial litigation, tort litigation, malpractice, it has been shown the number of participants and the transaction costs in resolving their disputes are reduced if you can keep it out of the courthouse.

So, yes, we do believe that virtually everything that would be contemplated, two or three, eight or otherwise, would have that transaction cost reduction effect.

Senator Hecht. Thank you.

In the National Association of Counties' proposed resolution on environment impairment liability, you call on Congress to enact legislation which would remove the strict liability provisions of the Superfund Act and other environmental impairment liability statutes, and return liability to a concept based on fault.

Clearly, the creation and maintenance of solid waste landfills are essential services to be performed.

Would your proposal lessen the costs to local governments in providing this service?

Mr. Ruck. I think it would have to. One, it might bring back at least some possibility of risk prediction, whether that is done through self-insurance or actuarially sound commercial insurance.

LANDFILLS

One of the things that is of great concern to many of our jurisdictions, particularly our rural jurisdictions, is that counties, and to some degree, other units of government, are now being forced to take over the function previously being performed by private landfills—private landfill owners who are faced by EPA, congressional and State requirements are going out of business.

Somebody has to pick the garbage up and somebody has to get rid of it. And, unfortunately, from a financial point of view, that's us.

Senator, what happens is, we take over an existing landfill and there are toxic wastes from the local hospital put in there 10 years ago. We've only run it for the last 2 or 3 years. And we've been trying to do it right.

We can prove that we've done it right for the 3 or 4 years we've run it. But, under the existing case law and under the existing language of CERCLA and the other environmental statutes under

APPENDIX A

U.S. CONFERENCE OF MAYORS POLICY
Adopted June 18, 1986

Liability Insurance Reform

WHEREAS, the availability and affordability of insurance against liability presents critical, often insurmountable, problems for local governments; and

WHEREAS, additional uniform data are needed from the insurance industry, and the Conference of Mayors should work with the National Association of Insurance Commissioners to secure these data, demonstrating the correlation between an insured's risk and the ability to obtain insurance against liability; and

WHEREAS, in the period since 1945, while states have maintained responsibilities for regulation of the insurance industry, there have been numerous "hard" and "soft" cycles in the insurance industry; and

WHEREAS, recent Justice Department recommendations regarding liability insurance address only tort reform and apply only to the federal government and its contractors; and

WHEREAS, a variety of options have been proposed for resolving the current critical liability insurance situation; and

WHEREAS, the insurance industry, including liability carriers, has been exempted from federal antitrust laws, with regulation being left to the states, resulting in a lack of uniformity in liability insurance throughout the 50 states; and

WHEREAS, another area of potential financial exposure in the federal judicial system is the award of attorney's fees to a successful plaintiff in addition to his damage award,

NOW, THEREFORE, BE IT RESOLVED the Conference of Mayors calls upon the federal government to provide leadership on this national problem. The following remedies should be explored by the Congress and the Administration:

comprehesive, impartial data collection regarding the relationship, if any, between the risk associated with a potential insuree and ability to obtain liability insurance protection;

review of the McCarran-Ferguson Act, with an eye toward possible changes that would create a federal role in insurance regulation;

tort reform in conjunction with administrative and regulatory reforms;

removal of current barriers to inter and intra-state pooling by local governments;

creation of a federal reinsurance mechanism; and

BE IT FURTHER RESOLVED the United States Conference of Mayors, in order to lower the financial exposure of local governments, urges the Congress to enact legislation allowing governmental units lower than a state government to use the defense of the 11th Amendment which prohibits a monetary judgment being entered aginst a state in federal court; and

BE IT FURTHER RESOLVED that the United States Conference of Mayors urges Congress to repeal or modify the sections of federal law providing for the awarding of attorney's fees in addition to damage awards.

APPENDIX B

City of Lincoln County/City Building Lincoln, Nebraska 68508 Telephone (402)471-7511 Roland A. Luedtke, Mayor

LINCOLN

OFFICE OF THE MAYOR
JOHN C. EVANS
Administrative Assistant
M. DAVID SALLEE
Administrative Assistant

April 30, 1986

The Honorable Hal Daub
Member of Congress
1019 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Daub;

Thank you for the information on your recently introduced Tort Liability Reform Act of 1986, and for your active interest in this critical area. Certainly none of us wants to deny to injured parties just compensation for injuries caused by another; the current situation, though, can only be viewed as a crisis. There does not seem to be any direct relationship between amount of anticipated loss and the cost of insurance against that loss, nor, according to some news reports, between the degree of culpability and financial liability. I share your view that tort reform is probably the only avenue for correcting the basic causes of the current situation.

I have to say that we have not yet been hit with some of the astronomical increases in premiums for general liability and automobile insurance that some Cities have experienced, although I have no doubt that they are coming as soon as we attempt to renew our current policies. As precursor to those increases, we have recently been presented with premium quotations for liability insurance for our City-owned public transit system that we consider unconscionable. The recent decision by the City Council was that the premiums quoted to us for liability insurance for the Lincoln Transportation System (LTS) are too high for the risk covered and that we should proceed with self-insuring against these losses. There is in fact a very significant risk for the City, though.

It's difficult for us to believe that our claims experience is in any way the cause of any change in the availability or cost of liability insurance. In the past five years, our experience for LTS has been an average total of claims paid (plus reserves for claims still open) of $71,697 per year, with the highest year being 1983-'84, during which a total of $106,744 was paid for one hundred eighty-four occurrences. Through that period, all claims were covered by "first dollar coverage" policies, and all individual claims paid have been under $100,000. We are not aware of any significant force that will cause a future increase in claims other than inflation.

Premiums for liability insurance for LTS have been steadily increasing, with last year's original premium paid being $155,580, for a policy with a limit of $10,000,000 and an effective date of February 1, 1985. Based on our experience and best judgment, we had LTS budget $194,475 for renewal of this coverage during the 1985-'86 Fiscal Year. Half way through the policy year, but after it was too late to increase the appropriation for insurance, we received notice from the company that they were charging an additional premium of $74,909, due September 1, 1985, for the remaining five months of the policy. This brought the total twelve month premium charged, for $10,000,000 "first dollar" coverage, to $230,489.

To this day, and despite consulting with a number of brokers and other sources, we have been unable to obtain quotes on liability insurance for the Lincoln Transportation System with the former limits; we have received quotes on insurance with lower maximums and with deductibles or self-insured retention features.

Of policies with coverage for "smaller" claims, the most recent quote we've received is for $750,000 of coverage, which would be in excess of a $250,000 deductible per occurrence, with no aggregate limit. The premium for this would be $154,800, with the additional requirement that the City deposit $175,000 in an interest earning account of the insurer for the payment of deductibles by the insurance carrier. Unlike the deductible policies that we may be familiar with in our personal lives, the costs of investigation, defense, and settlement would be included as a part of the deductible, rather than being an administrative expense of the insurer. Remember that our largest single claim has been under $100,000, well below the $250,000 deductible just described.

One other policy that may be of interest is one with a limit of $4,000,000 insured excess over $1,000,000 "self-insured retention," per occurrence. The premium for this was quoted at $141,984. This policy would require us to pay the first million dollars of any occurrence, and the insurer would then pick up any amount above that million. In a way, this might seem to fit the recent Nebraska law, in that it would provide coverage between the first million to the maximum five million dollar judgment against us. I understand that in the insurance industry this is called a "sleeper": you'll in all likelihood never use it, but it helps you sleep at night, knowing it's there. The problem would still be, of course, that $142,000 is not a cheap night's sleep, particularly when you don't have the $142,000.

What options do we have? One future possibility, assuming the adoption of enabling legislation, is an insurance "pool." Currently, municipal insurance pooling is not available in Nebraska, and in fact for Lincoln it may not be desirable. Under an insurance pool, municipalities who are members of the pool become jointly liable for claims against any member. Although without the actual wording of a statute to judge from, this probably would not be to the advantage of Lincoln. Since Lincoln is relatively large compared to almost all other cities of the State, and risks not being directly related to size, Lincoln could be assuming a risk disproportionate to the amount being

Congressman Hal Daub
April 30, 1986
Page 3

shared with others in the pool--we might be gaining more risk than security. Nonetheless, if and when the Unicameral does adopt a law that permits this kind of pooling, we will closely examine it for possible advantages to the City of Lincoln.

That brings us to self-insuring. The City, just like an individual, has the option of not carrying liability insurance at all, thereby being "self-insured." The essential question is, how do we weigh the risk to the City of being without liability insurance against the cost of insurance? As noted above, in our experience with the Lincoln Transportation System, the largest single claim paid was less than $100,000. There is absolutely no guarantee that we won't have a $5,000,000 judgment against us next week, but we have no basis on which to make that kind of prediction. To insure against the major claims would require premiums greater than our highest previous claim paid, and still leave us liable for payment of all claims that we actually expect: those below one or even two hundred thousand dollars.

Specifically with regard to the policy that provides for insurance of $750,000 in excess of a $250,000 deductible for a premium of $141,984, the obvious disadvantage is that the premium is one and one-half times our highest claim experience while the deductible is over two and one-half times that experience. This policy would provide only for a major incident, and then pay a maximum of $750,000 towards an award. While the company would provide all necessary claims-handling services, the costs for those would be included in the deductible, which means the City would be paying for them, not the company.

In summary, I would say that this is another case of "damned if we do and damned if we don't." In the future, I fervently hope that we can look back and know absolutely that we made the right decision today; that we will have had no disastrous judgments against us and that we saved a lot of money by not paying those astronomic premiums. There is some possibility that someday we'll look back and wish we had cut somewhere else to come up with those premiums dollars--I hope not, but my crystal ball is a little cloudy.

Congressman Hal, we appreciate all of the efforts that you are expending on behalf of the Cities and the people who have to pay the bills, one way or the other. I hope that this discussion is of some help to you; if there is anything else we can do, please call on us.

Very truly yours,

Roland A. Luedtke
Mayor of the City of Lincoln

APPENDIX C

UNITED STATES CONFERENCE OF MAYORS
1620 EYE STREET, NORTHWEST
WASHINGTON, D.C. 20006
TELEPHONE (202) 293-7330

LIABILITY INSURANCE SURVEY

I. BACKGROUND

a. City:____________________________

b. Population:________________________

c. Annual Operating Budget, FY86:____________

d. Please complete the following chart.

POLICY

	Comprehensive General	Police, Professionals	Property	Other	Other
Self Insured					
Private					
Pool					
Combination					
Other					
None					

3/86

e. Since 1981, has your city or any of its officials or employees been sued under 42 U.S.C. Section 1983 (Civil Rights Act)?

Yes________ No________

If Yes, what is the number of suits brought in Federal Court _____.
What is the number of suits brought in State Court_____.

f. Since 1981, what is the total number and amount of judgements of all kind against your city #____________ $____________.

g. Please describe the impact on your city of the current liability insurance situation, eg, services curtailed, cancelled or contracted out; requirements of waivers or releases from liability from service users; self insurance funds set aside thereby eliminating support for specific city programs; public officials' resignations, etc.

h. In your view, what is the major cause or causes of the current liability insurance situation?

II. SOLUTIONS

Proposed remedies include some of those listed below. Please check all that apply.

Tort Reform

State Level:

amend joint and several liability ______
cap awards ______
cap lawyers' fees ______
structured settlements ______
other____ ______
____ ______

Federal Level:

amend joint and several liability ______
cap awards ______
cap lawyers' fees ______
structured settlements ______
amend U.S.C. section 1983 (Civil Rights Act) ______
other____ ______
____ ______

Other

State Level:

prohibit mid-term cancellations ______

facilitate intra-state pooling ______

other______________________________ ______

____

Federal Level:

data gathering ______

oversight of state insurance industry operations ______

facilitate inter-state pooling ______

repeal/amend McCarran Ferguson Act ______

establishment of federal reinsurance fund ______

other______________________________ ______

______________________________ ______

III. ADDITIONAL COMMENTS

APPENDIX D -- RESPONDENTS

City	State	Population	Respondent	Title
Akron	OH	231,659	Richard A. Merolla	Budget Director
Alameda	CA	63,852	Robert L. Wonder	Assistant City Manager
Amarillo	TX	155,356	Don Cates	Director of Finance
Anaheim	CA	226,467	Thomas L. Vance	Risk Manager
Anchorage	AK	194,675	Harry E. Sjoberg	Risk Manager
Ann Arbor	MI	104,880	Donald L. Mason	Asst City Administrator
Arcadia	CA	45,994	Jerry Shuster	Finance Director
Arlington	TX	182,975	Peter Potemkin	Risk Manager
Artesia	CA	14,301	B. Eugene Romio	Asst City Manager/Risk Mngr
Aurora	CO	184,372	James Harrington	Acting Risk Manager
Baltimore	MD	774,113	John Donaho	Consultant to the Mayor
Bellflower	CA	53,441	Julia A. Norris	Administrative Asst
Bellingham	WA	45,794	The Hon. Tim Douglas	Mayor of Bellingham
Bloomington	IL	47,095	Allan W. Horsman	Director of Finance
Bossier City	LA	49,969	Charles M. Dudra	Safety and Claims Officer
Brigham	UT	15,596	Michael T. Cosgrove	City Recorder
Brockton	MA	95,192	John R. Buckley, Jr.	Administrative Assistant
Buena Park	CA	64,165	Lynda Ritter	Personnel Intern
Cedar Rapids	IA	109,086	William J. Kinney	Asst City Controller
Champaign	IL	58,133	F.C. Stavins	City Attorney
Charlotte	NC	323,972	C. J. Spivey	Risk Manager
Chester	PA	45,794	Thomas E. McCue	Dept Dir Accts and Fin
Cheyenne	WY	47,283	Bill Springer	Risk Manager
Chicago	IL	2,997,155	S. Nathan Williams	Risk Manager, City of Chicago
Chula Vista	CA	115,000	Diana M. Levin	Risk Manager
Clearwater	FL	85,450	G. B. Weimer	Assistant City Manager
Colorado Springs	CO	231,699	Darrel Barnes	Risk Manager
Columbus	GA	174,348	Walter J. Wright, Jr.	Director of Administration
Dallas	TX	943,848	Mark Ferraro	Risk Manager
Davis	CA	36,640	Albert T. Fierro	Administrative Assistant II
Dayton	OH	188,499	Lawrence C. Barker	Purchasing Agent
Decatur	IL	94,081	Caniel R. Sommerfeldt	Risk Manager
Des Moines	IA	191,506	Martin K. Frederickson	Finance Director
Detroit	MI	1,138,717	Dorothy V. Brodie	Exec Asst to the Mayor
Dothan	AL	48,750	Larry Muench	Program Director
Dunedin	FL	30,203	Maureen Freaney	Risk/Safety Officer
East Brunswick	NJ	37,928	Wendy Wolff	Assistant Administrator
El Paso	TX	445,071	Milan Rice	Insur and Benefits
Elizabeth	NJ	106,803	John F. Papetti, Sr.	Business Administrator
Erie	PA	118,493	Mrs. Lucille Eberlein	Insurance Secretary
Euclid	OH	59,999	Raymond J. Drescher	Risk Manager
Evansville	IN	130,275	Rebecca Dixon	Finance Officer
Ewing	NJ	34,842	Richard J. Prettyman	Treasurer
Fairfield	CA	58,099	Oscar G. Reyes, Jr.	Asst Finance Director
Farmers Branch	TX	24,863	John P. Cavanaugh	Training and Safety Officer
Flint	MI	154,019	Stephen A. Hill	Risk Manager
Fort Worth	TX	401,402	Bill Herrington	Asst Personnel Director

City	State	Population	Respondent	Title
Fresno	CA	244,623	Cliff Fisher	Risk Manager
Fullerton	CA	104,532	D. R. Dickinson, Jr.	Risk Manager
Galveston	TX	61,902	Jack C. Elliott	Risk Manager
Garland	TX	149,957	Virgil Miller	Asst City Manager
Gastonia	NC	47,333	Gary Ottich	City Manager
Grand Prairie	TX	71,462	M. Wayne Usry	Finance Director
Greenville	SC	58,282	Stephen A. Kern	City Attorney
Greenville	NC	32,740	The Hon. Leslie H. Garner	Mayor of Greenville
Hamilton	NJ	82,801	The Hon. John K. Rafferty	Mayor of Hamilton
Harlingen	TX	43,543	Daniel R. Gutierrez	Administrative Assistant
Hawthorne	CA	56,477	Avery J. Knapp	Deputy City Attorney
Hayward	CA	94,167	Harry R. Bruno, Jr.	Risk Manager
Highland Park	IL	30,600	Marilyn Dolan	Asst. to City Manager
Highland Park	MI	27,909	Anthony P. Jackson	Risk Manager Adm.
Honolulu	HI	781,899	James E. Ross	Deputy Corporation Counsel
Houma	LA	101,319	Earl C. Fischer	Parish Insurance Manager
Huntsville	AL	145,421	Cantey Cooper	Asst. City Attorney
Irvine	CA	64,134	Brad Landreth	Management Analyst II
Irving	TX	114,305		
Jacksonville	FL	556,370	Gail Shuffler	Insurance and Risk Manager
Jersey City	NJ	222,881	Dominick S. Cinelli	Risk Manager
Joliet	IL	77,956	The Honorable John Bourg	Mayor of Joliet
Kansas City	MO	443,075	Joseph Wells	Insurance Administrator
Kettering	OH	61,186	Robert E. Hunter	Assistant Law Director
Knoxville	TN	175,298	Abigail S. Hudgens	Administrative Assistant
Kokomo	IN	47,808	Kenneth J. Ferries	Corporation Counsel
Lansing	MI	128,338	The Hon. Terry J. McKane	Mayor of Lansing
Las Cruces	NM	45,086	Richard Hodgin	Risk Manager
Lewiston	ME	40,481	Richard T. Metivier	Finance Director
Lincoln	NE	181,500	Howard H. Fletcher	Risk Manager
Louisville	KY	293,531	Kevin O'Donnell, CPCU	Risk and Insurance Manager
Lubbock	TX	176,588	Rod Bouffard	Assistant Director of Finance
Manitowoc	WI	32,547	Patrick L. Willis	City Attorney
Mankato	MN	28,651	Ben Mercer	Purchasing Director
Maple Heights	OH	29,735	Michael S. Dernyar	Exec Asst to Mayor
Maui County	HI	60,088	Henry T. S. Lau	Director of Finance
McAllen	TX	67,042	Joe I. Banda	Risk Manager
Melbourne	FL	46,536	Walter O. Barry	Assistant City Manager
Memphis	TN	646,356	Jean E. Mardowitz	Claim Agency/Risk Manager
Meridian	MS	46,557	Robert Klimetz	Chief Administrative Officer
Mesa	AZ	171,695	Randall Fleischhauer	Risk Management Administrator
Milwaukee	WI	631,509	William C. Carey	Assistant Director
Minneapolis	MN	369,161	Robert J. Alfton	City Attorney
Morristown	NJ	16,614	Terence J. Reidy	Business Administrator
Modesto	CA	114,076	James Lippert	Risk Manger
Muskegon	MI	40,823	Timothy J. Paul	Director of Finance
Nashua	NH	67,865	Peter P. Cyr	Risk Manager
Nashville	TN	455,252	James D. Luther	Deputy Director of Law
New Castle	PA	33,500	Denis P. Lemieux	City Administrator
New Orleans	LA	564,383	Leroy J. Aucoin	Assistant Chief Admin
Newark	NJ	320,512	Pearl Beatty	Insur Risk Mgr/Specialist
Newton	MA	83,622	The Hon. Theodore D. Mann	Mayor of Newton

City	State	Population	Respondent	Title
North Little Rock	AR	64,419	Bob Sisson	Finance Director
Northglenn	CO	29,847	Linda Reno	Risk Manager
Oak Park	IL	54,887	Allen D. Moore	Finance Director
Oklahoma City	OK	427,714	W. R. Hale	Risk Manager
Orange Township	NJ	31,136	Donald F. Wilson	Insurance Broker
Orlando	FL	134,255	John J. McHugh	Assistant Comptroller
Paducah	KY	29,305	Carl Holder, Jr.	City Manager
Parkersburg	WV	39,967	Randall Craig	Accountant
Peoria	IL	122,261	Charles C. Cumby, Jr.	Deputy City Manager
Pittsburgh	PA	423,938	George W. Jacoby	Director, Dept of Gen Services
Plainfield	NJ	45,555	Peter P. Sepelya, Jr.	Director
Portland	OR	367,530	John Hoffman	Risk Operations Supervisor
Quincy	IL	42,352	Gary M. Peters	Comptroller
Redondo Beach	CA	57,102	Larry Peterson	Asst to City Manager
Richardson	TX	72,496	Howard Weaver	Director of Personnel
Riverside	CA	174,023	Jerry Rivera	Sr. Administrative Asst
Roanoke	VA	100,187	D. Darwin Roupe, CPPO	Manager of General Services
Rochester	MN	57,855	David Wernecke	Purchasing & Insurance Officer
Roswell	NM	39,676	John E. Capps	City Attorney
Sacramento	CA	288,597	William Redmond	Risk Manager
Saginaw	MI	77,508	David Rupp	Controller
Salt Lake City	UT	163,859	Jane Erickson	Risk Manager
San Juan	PR	522,700	Aida Carrillo De Jesus	Insurance Office Director
Sandy City	UT	51,022	Mark Paterson	Director of Admin Services
Santa Barbara	CA	74,542	R.B. Bouma	Asst Finance Director
Santa Fe Springs	CA	14,599	Frederick W. Latham	Asst City Manager
Santa Monica	CA	88,314	Tom Phillips	Risk Manager
Shaker Heights	OH	32,487	William J. Schuchart	Chief Administrative Officer
South Bend	IN	107,690	Michael L. Vance	Director of Dept of Admin
Spokane	WA	171,903	Peter Fortin	Manager - Finance
Springfield	MA	152,319	Harry P. Carroll	Deputy City Solicitor
St. Louis	MO	437.354	James J. Wilson	City Counselor
Suffolk	VA	47,621	Leon Johnson	Director of Finance
Sunnyvale	CA	107,110	Julius C. Scoggins	Risk and Insurance Manager
Syracuse	NY	166,187	Kenneth Mokrzycki	Director of Administration
Tacoma	WA	161,351	L.D. Metzger	Risk Manager
Thousand Oaks	CA	77,797	Mark G. Sellers	City Attorney
Toledo	OH	350,565	John Plock	Risk Management Officer
Torrington	CT	30,987	Dino M. Borghesi	City Comptroller
Vallejo	CA	80,188	Susan Gonzales	Administrative Assistant
Virginia Beach	VA	282,588	Robert W. Esenberg	Risk Management Administrator
Washington	DC	633,425	John Suda	Acting Corporation Counsel
Wilmington	DE	70,195	A. Richard Heffron	Special Asst to the Mayor
Winston-Salem	NC	140,846	Ronald G. Seeber	City Attorney
Wyandotte	MI	34,006	William R. Look	Attorney at Law
York	PA	44,619	Steven A. Martin	Personnel Director

strict liability, if we own the property, we are responsible for any leakage or any other environmental impairment that may have occurred years and years and years before we even took acquisition of that property.

We think that's something that should be addressed because there are going to be jurisdictions who cannot get this insurance right now. This insurance will not be written right now by any carrier for any public entity in the country. And we are forced to, in furthering the public interest, sometimes mandated by our State legislatures, to take over this property. We have no way to spread the risk for this.

You are going to see cities and counties going under once some of this environmental impairment litigation starts to hit us.

Senator HECHT. Thank you very much.

Another panel that's so well-informed, we'll be back to you from time to time, with your permission.

Mr. RUCK. If I just might add for the numbers game, Senator, the cost of financing risks for local government. We don't just call it insurance because it includes insurance premiums, self-insurance set-asides, and our own risk management internal functions. These costs have recently been shown to be, depending upon the size of the jurisdiction, between 2.45 and 5 percent of the operating budgets of our counties, cities and towns.

That's up approximately 150 percent from 2 years ago, Senator.

Senator HECHT. I thank you. You know, when you have these figures and you can give them to the press, they understand exactly and the people understand exactly.

Thank you very much.

Mr. RUCK. Thank you very much.

Senator HECHT. Let's get to our next panel.

David M. Farmer, vice president, Federal affairs of the Alliance of American Insurers; Robert L. Zeman, assistant counsel of the National Association of Independent Insurers; and William L. Larsen, senior counsel, Federal affairs of American Insurance Association.

Mr. Farmer, would you like to start, please?

STATEMENT OF DAVID M. FARMER, VICE PRESIDENT, FEDERAL AFFAIRS, ALLIANCE OF AMERICAN INSURERS

Mr. FARMER. Thank you, Mr. Chairman.

My name is David M. Farmer, vice president of Federal affairs for the Alliance of American Insurers, a voluntary membership organization of 175 property and casualty companies whose members provide coverage to millions of American homes and businesses.

We have concern for the cities, counties, and towns and the doctors and the other groups of individuals who are having difficulty securing coverage, the kind of coverage that they want, or that price increases have been more than they can pay.

We would simply say that business conditions have justified those actions.

The civil justice system in the United States is out of control. People are afraid of their judicial branch of Government. People are afraid to operate their businesses without liability insurance, even people who operate their businesses or professions in a safe and nonnegligent manner, simply because they have assets.

CHARGE OF INSURANCE CONSPIRACY IS BASELESS

The casualty insurance industry has been on trial in the last 6 months. There have been allegations of conspiracy, of a boycott, of overcharging, of mismanagement.

I think some understanding of the facts is important. That is why this hearing is important and this committee's inquiry, along with others is helpful to that understanding.

What are the facts?

The Federal Trade Commission, Antitrust Division of the Department of Justice have investigated these charges, have found them to be baseless. The investigation has been closed.

The charge that there is no liability insurance crisis or that it is a manufactured crisis is specious, is false.

I think we need to look beyond the private sector and look to government. What has been the experience of government?

The city of New York is a self-insurer. There is no commercial insurance company involved. Over the course of the last several years they have seen a 300-percent increase in the amount of payments.

I think one statistic is very interesting, and I want to make sure that I get it precisely correct.

In the Tort Section of the Justice Department, in 1975, there were 39 lawyers handling 4,000 cases, with $1 billion in claims against the Government. In 1985, there are 124 lawyers handling 11,000 cases, with claims of $200 billion.

That is not the insurance industry. That is New York City. That is the Federal Government.

And so to suggest that there is no litigation crisis is to defy reality. I would submit to you that those who suggest that there is no litigation crisis have a vested interest in preventing tort reform, which is the only way to control underlying loss costs.

You ask the question in your letter of invitation: Have alternative systems of insurance been developed? Are there a number of increases in captive companies?

The answer is "yes". We have some history to reflect upon that. Medical malpractice has been in crisis 10 years. Doctors 10 years ago formed companies to self-insure.

If you look at the record of those captives that were formed by the doctors, not the insurance industry, it has been less than satisfactory. Their premiums have escalated in certain States where involuntary mechanisms were formed and where the insurance industry involuntarily had to write medical malpractice. In some States as much as 82 percent of the marketplace is written involuntarily.

In New York State, the Doctors Mutual Co., if it were a regular company, its solvency would probably be questioned because of the shortfall.

The record is clear as to where we are. What should we do about it? What can we do about it?

I think the answer is that the Congress in the areas where there's jurisdiction by the Federal Government needs to change the law, needs to look at Superfund.

And we have looked at Superfund, and insurers in cities and counties and towns came and said, we need to do something about joint and several liability. We have just gone through a legislative round of Superfund, and nothing was done.

We would hope that we can have a balanced system.

Senator HECHT. Summarize.

Mr. FARMER. In conclusion, casualty insurers want to work with their customers and want to work with the Congress, but we need to address a fundamental problem; that is, the litigation crisis in America.

[The complete prepared statement follows:]

STATEMENT

OF THE

ALLIANCE OF AMERICAN INSURERS

BEFORE THE

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

ON

LIABILITY INSURANCE REFORM

MAY 15, 1986

Mr. Chairman, my name is David M. Farmer and I am Vice President, Federal Affairs, for the Alliance of American Insurers. The Alliance is a voluntary membership organization composed of over 175 property and casualty insurers. Our members provide property and casualty insurance to millions of homes and businesses throughout the United States. We are pleased that the Subcommittee on Housing and Urban Affairs has chosen to examine the current situation as respects liability insurance and appreciate the opportunity to express our views.

During recent months, there has been expressed an increasing concern from some quarters about the problems of securing liability insurance for some businesses and professions; for others, concerns about cost have been expressed. From the outset, let me say that we share their concerns. Actions taken by individual insurers that have an adverse impact on our customers are not ones that are taken lightly or without an awareness of the consequences. We believe, however, that business judgement necessitated the actions that have occurred.

We need to examine the legal climate and the financial conditions of insurers to understand what has happened to the insurance marketplace over the last several years.

The legal climate is not a static environment, it is a changing one. One in which society, through legislative and judicial bodies, determines the rights and remedies of parties to a dispute. Over the past ten years, some significant changes have occurred. In state courts, the latest studies show an increase in litigated cases of 22% from 1977-1981. In 1962, only one civil award amounted to $1 million. In 1982, there were 251 awards of $1 million or more.

The problems of a runaway civil justice system are by no means confined to private defendants. The U.S. Government is increasingly involved as a party in lawsuits.

U.S. Deputy Attorney General, Carol Dinkins, reported that nearly 11,100 cases involving the U.S. Government were filed in the Federal District Court for the twelve-month period ending March 1984.

The civil justice system in this country needs change -- not tomorrow, but today. Left unchecked, this system will engulf our ability to compensate victims of injuries. Already, the insurance industry has lost the ability in certain lines to adequately price the cost of coverage. Two particular examples of this are pollution liability and liability for asbestos removal operators.

Liability insurance is a vital part of our modern economy and because of governmental mandate, a necessity for some businesses.

On the financial side, the industry is beginning to recover from one of the worst down cycles in the history of U.S. property and casualty insurance.

In this environment, insurers face problems where they must allocate available capital. In lines of business where there is complete uncertainty about the present and future, companies are no longer providing coverage. A number of casualty insurers are still in a difficult financial position and some carriers have gone out of business over the course of the last several years.

We have seen problems in a variety of liability coverages, although I would add that the problems are not occurring in every state or jurisdiction. They vary by state and by line of coverage.

In the following pages of my testimony, I will attempt to describe some of the problem areas of liability coverage and some possible solutions.

Municipal Liability

The municipal liability problem can be traced to the erosion of a well-settled principle of law that governmental entities could not be sued without their consent. That is, the federal and state governments and municipal corporations which have power to legislate, as well as counties, townships, and unincorporated divisions of a state, traditionally were not liable for damages for their neglect of public duty.

Since the mid-1970s, state legislatures and the judiciary have significantly eroded the doctrine of sovereign immunity, particularly in regard to municipalities. In some cases, amendments to state constitutions or changes in state law totally or partially abolished sovereign immunity as applied to local units of government, particularly as to municipalities. In addition, the courts generally hold that where the legislature by statute abrogates the immunity of the state from liability, such laws also repeal the immunity of municipal corporations, counties, towns and all other political subdivisions of the state.

Not only have the courts eroded the doctrine of sovereign immunity, they also found other avenues to create liability where none previously existed. The courts have held municipalities liable for violation of the constitutional rights of citizens and have also required municipalities and other local government entities to indemnify claims against municipal employees.

Recent surveys indicate the dramatic growth in the size of judgments and awards against cities. Based on a 1982 survey of 937 cities, the largest amount sought was $40 million. In 1985, the 1,244 cities surveyed responded that awards were being sought in the $100-$200 million range. Additionally, the number of lawsuits filed against public officials has doubled since 1982. Both the frequency and severity of liability awards have increased as well as reported in the recent national report on public officials liability done by the Wyatt Company.

Solutions to these problems are being actively considered by states, including the re-establishment of sovereign immunity, at least on a basis limited to certain defined activities; the adoption of better risk management activities (e.g., equipment maintenance, loss control plans); improved safety plans; and limitations on recovery of damages sought in citizen suits.

Environmental Liability

At the center of problems associated with the availability of pollution liability insurance is the fact that liabilities against policyholders for cleanup, personal injury, and property damage are created by multiple federal and state statutes as well as by common law. Interacting with this are court interpretations of prior insurance contracts expanding coverage beyond that which insurers intended. As a result, availability of insurance for current pollution liability is significantly influenced by insurers' concerns about potential unanticipated past liability; the magnitude of potential pollution liability, both past and future; the seeming inability to use contract language to prudently limit insurers' exposure; the complexity and expense of underwriting the coverage; the unsettled state of the technology used to dispose and clean up toxic and hazardous substances; the fact that demand for coverage has been confined mostly to entities with a high probability of sustaining large losses, causing problems in risk spreading; and a civil justice system that continues to create new theories of liability and to expand older theories. Further adding to insurers' uncertainties is that these other events occurred at a point in time when environmental impairment liability insurance was just beginning to be offered by relatively few writers and little claims data was available.

In discussing solutions, it is necessary to separate fundamental solutions from short-term transitory ones. Furthermore, solutions for one statutory problem may have relevance in other settings but require separate action. Amendments to the Federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), the Superfund Law, also would be applicable to the state copies of Superfund (in about 40 states). Moreover, amendments to one law only may increase the likelihood of coverage under another. For example, one factor in the lack of available insurance to meet the financial responsibility requirements of the Resource Conservation and Recovery Act (RCRA) is the fear that today's RCRA sites will become tomorrow's Superfund cleanup target. It also must be recognized that sometimes two events converge to produce a problem. For example, the insurer problems with Superfund are the result of interaction of the provisions of the Superfund law, as administered by the EPA, with state court decisions reading out coverage limitations or exclusions in insurance policies regarding pollution liability. Problems under the federal Superfund law include:

- Retroactive Liability - The provisions of the Superfund law apply retroactively to owners and operators of waste sites, transporters, and those who generated waste disposal at the site.

- Strict Liability - Liability exists even though the responsible party's acts or omissions were not the proximate cause of the leak and even though the substance leaking is not that which was deposited.

- Joint and Several Liability - The majority of courts ruling have held responsible parties jointly and severally liable and ignored their degrees of contribution to the toxic site.

- Excessive Transaction Costs - The present responsible party approach to Superfund, combined with joint and several liability, has resulted in high transaction costs. The monies spent by EPA could better be used to clean up sites, while insurers have faced investigation and legal costs that frequently are far in excess of any potential Superfund cleanup share.

In general, the availability for pollution coverage has declined over the past several years to the point where some operators have formed captives or insurance companies. One example of this is the recently reported formation of Waste Insurance Liability, Ltd., which was formed by the National Solid Wastes Management Association.

I would hasten to add that this is a short-term solution. There is a need to address the long-term liability problem in this and other areas.

A recent study by the All-Industry Research Advisory Council (AIRAC) identified six general areas that are consistent with previous observations by the Alliance and other industry groups:

1. Some of the provisions and interpretations of federal pollution laws make it difficult, if not impossible for the insurance mechanism to work. State pollution laws create similar difficulties in a few instances.

2. Courts in several key jurisdictions have imposed enormous retroactive liabilities on insurers for pollution damage and cleanup costs that were never intended to be covered. Insurers are concerned that the courts will not respect the intent of their future pollution contracts as well, no matter what language they use to describe the terms and limitations.

3. The reinsurance market for gradual pollution insurance has virtually disappeared because of adverse loss experience and concerns over legal trends in the United States.

4. Demand for gradual pollution insurance has been confined mostly to entities with a high probability of sustaining large losses, causing problems for insurers in developing enough insurance capacity to handle the

catastrophic risk involved. Insurers have yet to see the kind of broad demand that would enable them to build and sustain a robust market for the coverage, in part because the pollution laws have not been vigorously enforced.

5. The pollution hazard has turned out to be much more complex and expensive than anticipated. Gearing up to underwrite this catastrophic risk, it is now realized, requires major commitments of time and dollars, as well as expertise typically not available on staff.

Motor Carrier Liability

Against the background of generalized property/casualty insurer problems, the requirements for high limits of liability as mandated by the Motor Carrier Act of 1980 and the Bus Regulatory Reform Act of 1982 have placed a severe strain on the capacity of insurers and on their ability to accurately ascertain a financially sound course of action.

In addition to excessive financial responsibility limits of these statutes, other reasons for the current problems include:

- Deterioration in the quality of risks, particularly with regard to marginal operators and new operators who are less financially stable and have no safety record in their operations.
- Further, a number of states including Colorado, Connecticut, Indiana, and Pennsylvania have enacted or introduced within the last year legislation which extends the federal financial responsibility requirements to risks operating intrastate.

Solutions to availability problems include the redefinition of the types and sizes of motor carriers and passenger carriers required to carry the higher limits. In this context, an attempt should be made to exempt local carriers operating only intrastate from the federal requirements, leaving them to be separately regulated by the states. Other exemptions might be considered for carriers having only slight exposure to loss, based on maximum quantity and/or frequency or hazardous materials carried.

Directors and Officers Liability Insurance

Consumers of directors and officers (D&O) liability insurance, particularly financial institutions, report facing

larger deductibles, lower limits, more restrictive endorsements, shorter policy durations, and higher premiums. A survey of purchasers conducted during the second quarter of 1985 reported premium increases from 50 to 500 percent and, in a few industries, a true availability problem.

One example of the tightening market is a bank which had its limits reduced from $15 million to $10 million, its deductible increased from $50,000 to $750,000, and its premium increased 22 times. Financial institutions which had been able to obtain limits in 1984 up to $200 million are having difficulty now finding limits of $30 million.

Those industries experiencing particular difficulty are: financial institutions, electric (nuclear) utilities, new high tech businesses, wildcat oil and gas companies, research and development enterprises, real estate developers, highly leveraged businesses, petrochemical companies, and the steel industry.

Underlying problems responsible for the capacity shortage include:

- Significant reduction in reinsurance because of the general condition of domestic and foreign reinsurance markets, combined with reinsurers; perceptions of price inadequacy, the American civil justice system, and the increase in potential liability for directors and officers;
- Policyholders' well-publicized breaches of traditional relationships with D&O insurers, i.e., several large banks are suing some of their own managers and attempting to collect under their D&O policies;
- Federal agencies, such as FDIC and FSLIC, that have insured failed banks and savings and loans are attempting to recoup some of their losses by suing former directors and officers;
- Court decisions hold directors and officers to an increasingly strict standard of conduct by reducing the scope of the business judgment rule so that coverage designed for true mismanagement is becoming a "business judgment errors and omissions policy;"
- Increase in hostile takeovers and other business practices likely to generate claims (greenmail, poison pills, golden parachutes);

- A greater concern that directors and officers are not representing the interests of their shareholders may also result from recent corporate battles;

- The general financial condition of primary insurers;

- Growth in demand for directors and officers coverage; and,

- Underpricing in prior years.

In 1984, rates were 20 to 25% inadequate. Reports are that in 1984, D&O insurers were paying three to four times as much in claims as they received in premiums. Average policy limits increased by 45 percent between 1982 and 1984, with a dramatic increase for those purchasing limits over $50 million. The number of companies seeking D&O insurance increased by eight percent during this period with growth in demand greatest among companies with assets under $25 million.

The average defense cost for claims in 1984 was $461,000 up from $365,000 in 1982. Average total cost of a D&O claim (defense cost plus losses) adjusted for inflation was $1.62 million in 1982 (up 21%).

In the short term, banks and other financial institutions are looking for alternatives to traditional insurance. A number of them are in the process of forming an offshore captive.

These may offer a short term solution but will not address the underlying problems of escalating loss costs in this line of insurance.

Insurers recognize the social and commercial necessity of their product as well as the integration of insurance with sound public policy. The underlying problems in the environment of certain businesses as reflected in availability and affordability problems for certain coverages, deserve thoughtful solutions by insurers, their policyholders and public policymakers. These problems do not exist in all lines of commercial insurance, nor in all states nor to the same degree in each affected commercial activity. The prospective solutions vary in their applicability to each such problem and to segregated geographical areas where the problem has surfaced. What is clear is that the solutions should not be limited to insurance. What is needed in nearly every such troubled line is a stable business and legal environment. What is required to achieve that varies by the nature of the underlying problem.

The only long term solution in our view is reform of the civil justice system. Among the reforms that should be considered are:

- The replacement of joint and several liability with a system of several liability only -- Utah, Washington and Wyoming (1986).

- Limits on damage awards -- some capping of non-economic awards -- Maryland, Minnesota and Washington (1986).

- Contingent fee system -- a sliding scale system should be enacted to provide fair compensation for attorneys and a greater share of recovery for injured parties.

- Discovery abuse -- reduction of delays is important and courts should be given more authority to define the issues and weed out frivolous claims and defenses.

There are other reforms that need to be addressed and many states are in the process of addressing them at the present time. They are difficult issues, but if we are to restore a sense of balance to the system they need to be addressed.

The member companies of the Alliance want to provide insurance protection for our customers. In order to achieve a balance, we believe these reforms and others are necessary to achieve some stability and consistency in our legal system.

We want to cooperate with the Congress in resolving the current crisis of availability and affordability of liability insurance.

We appreciate the opportunity to express our views and will be happy to respond to any questions that members of the Subcommittee may have.

Senator **Hecht**. Thank you.

Let me just make sure I got that one statement. There are $200 billion in claims against New York State today?

Mr. **Farmer**. No. New York State——

Senator **Hecht**. What was that figure again?

Mr. **Farmer**. In New York City.

You might go on to the next topic.

Senator **Hecht**. OK, Mr. Zeman, and then I will come back to you.

Mr. Zeman, please start.

STATEMENT OF ROBERT L. ZEMAN, ASSISTANT COUNSEL, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

Mr. **Zeman**. Good morning, Senator.

On behalf of the National Association of Independent Insurers, I want to thank you for exploring the causes of the liability insurance crisis.

I may begin with a statistic that may be helpful regarding New York City. Presently, I can tell you, Senator, that you have over 11,000 tort claims pending against New York City right now. The total dollar cost I am not familiar with, but total claims exceed 11,000 in number.

Senator **Hecht**. I have just been informed by competent staff that that is against the Federal Government, not against New York State, $200 billion, which if I put it in the correct perspective, that is one-half of our entire defense budget.

Go on.

Mr. **Zeman**. Thank you.

My name is Robert Zeman, assistant counsel for the NAII, which is a voluntary property, casualty, and trade association representing about 500 property and casualty insurance companies.

I think we have heard some excellent testimony today regarding the fact that problems with our civil justice system lie at the core of this liability insurance crisis. I would like to identify with perhaps greater precision specifically how those problems in the system have impacted upon insurance companies and why we have this availability problem and what we can do about it.

INEQUITIES WITHIN THE CIVIL JUSTICE SYSTEM

I think it is absolutely clear that fundamental inequities within our civil justice system do lie at the core of this crisis.

During the 1970's and 1980's we have seen tremendous expansion of personal injury liabilities by the courts as well as an explosion in the number and amount of damages awarded in such suits.

Now, another factor which has exacerbated this problem involves previous underwriting practices of insurance companies. During the late 1970's and early 1980's, insurance companies drastically underpriced their policies.

During those years, the insurance industry experienced a fierce surge of competition, and they competed heavily for premium dollars which they could invest and obtain premium interest. For a short time, that investment income countered the losses that liability insurers were facing under their policies.

However, eventually, investment income was outstripped by the losses caused because of the civil justice system. As a result, in 1984 and 1985, we have had record underwriting losses within the insurance industry.

For example, in 1985, just on the policies we wrote, our companies paid out $25 billion more than they took in, in premiums. This is one of the immediate causes of this availability crisis.

The adverse economic consequences for the insurance industry during these years meant that they simply had less money that they could use to insure some of the more dangerous risks. So they were forced to stop insuring some of these more dangerous risks.

Now, in the face of these availability problems, insurance companies have taken some positive steps, we think, to help alleviate some of these availability problems. Some of these steps include participation in the voluntary market assistance programs that have been set up in about 35 States. These programs will continue to alleviate availability problems to a certain extent.

However, the only way to get at the root cause of this whole insurance crisis is to resolve these fundamental inequities within our tort system.

During the 1970's and through the 1980's, courts have not only expanded on traditional theories of liability, they have created new theories of liability. Just two examples, if I may.

Several courts have refused to allow into evidence the state-of-the-art defense in product liability suits. Essentially, that means that the manufacturer is liable for a consumer's injuries arising out of the use of a product even though the manufacturer used every technological and scientific means available at the time to ensure the safety of the product.

Another example may be found in the use of different types of market share theories, under which if a consumer cannot identify the specific manufacturer of a product that injured, he can sue virtually every manufacturer of that type of product and collect from them in proportion to that manufacturer's market share.

The point of these and other cases is that the courts have expanded these liabilities at the expense of traditional concepts, traditional personal injury law concepts of causation-based liability, of fault-based liability.

Now, what has this done to the insurance industry?

It has done away with all standards of predictability on which underwriters must hang their hats. Predictability is the essence of insurance, but underwriters do need some legal basis for predictability on which they can underwrite risks.

TORT SYSTEM HAS DESTROYED PREDICTABILITY

What has happened is our tort system has destroyed this predictability and resulted in some of these availability problems.

We think it is clear that the tort system must be reformed. There is no doubt about that.

Many of the reforms mentioned in the proposals would go a long way toward ameliorating the crisis, we think, all figures and rhetoric aside. Just look at the joint and several liability rule for a second.

It means that any one of several defendants can be liable for all of the plaintiff's damages, even though that one defendant was only minimally negligent. Just on its face, we think that doctrine is so unfair, and now we can see with the data how the unfairness has had adverse economic consequences for the insurance industry.

There are a number of other tort reforms with which we are all familiar, and I won't belabor them at this point. However, we do think that several other major reforms will go a long way toward ameliorating the availability crisis, such as caps, reasonable limits on noneconomic damages or damages such as pain and suffering.

Those damages are so impossible to ascertain with precision, and they are subject to the emotion of the jury, and that is why we have seen explosions in noneconomic awards. We don't want to cut them out altogether, just put reasonable limits on them.

In summary, we think there is no doubt it has been made clear today that the problems of insurance availability and affordability are due to problems, fundamental inequities within the civil justice system. Those deficiencies, however, lie primarily at the State level, and they must be resolved by State policymakers.

In fact, we are happy to report that already in 1986 approximately 10 States have enacted significant reforms. There are many other States that are still in session, and I can tell you with total honesty, Senator, there is clear momentum in the States for enacting many of the reforms that have been discussed today.

At this point there is no need for Federal preemption of traditional State law in this matter.

Once again, Senator, I sincerely commend you for exploring the problems within the liability insurance system, and I look forward to working with you and other Federal and State policymakers in the future.

[The complete prepared statement follows:]

In conclusion, predictability and insurability can only be restored through reformation of the civil justice system. Deficiencies within our personal injury law lie primarily at the state level and must be resolved by state legislators and regulators. The personal injury liability reforms outlined in the proposals will send an important signal to the states. In fact, we are happy to report that already in 1986 approximately ten state legislatures have enacted significant tort reforms, and many others are currently considering similar action. There is clear momentum developing in the states for changes in our personal injury law.

Once again we commend you, Senator Hecht, for exploring the important issue of the insurance crisis and for recognizing that the tort system in this country needs careful attention. We appreciate the opportunity to express our agreement with you as to the necessity for reform. We will continue to work with you and other federal and state policymakers to resolve these problems and assure availability of insurance for all consumers in the United States.

Senator HECHT. Thank you very much.
Mr. Larsen.

STATEMENT OF WILLIAM L. LARSEN, SENIOR COUNSEL, FEDERAL AFFAIRS, AMERICAN INSURANCE ASSOCIATION

Mr. LARSEN. My name is William L. Larsen. I am senior counsel for Federal affairs for the American Insurance Association.

The AIA is a trade association that represents 170 property and casualty insurance companies. Member companies of the association represent approximately 35 percent of all commercial premiums written throughout the United States.

To start off, I would like to associate myself with the comments of my colleagues here on my right and perhaps I will just be reiterating some of the points they have already made.

But quite simply, we feel the roots of the current problems in availability and affordability of liability insurance lie in the unprecedented losses and rapidly changing operating environment experienced by insurers in recent years.

Since 1979, property and casualty insurers have suffered evergrowing underwriting losses. In 1985, property and casualty underwriting losses totaled $24.7 billion. In 1985, underwriting losses exceeded investment income by $5.4 billion.

$9 BILLION OPERATING LOSSES IN LAST 2 YEARS

With over $9 billion in operating losses in the last 2 years, property and casualty insurers recently have begun to raise premiums to keep pace with losses.

Just as insurer losses have been dramatic, in some cases premium increases have also been dramatic—to the consternation of policyholders used to bargain basement prices for insurance. These prices for policies were low, and in some cases we feel the explanation for the seemingly extraordinary rises in policy rates is linked to the fact that they were cutrate at the time when insurers were engaged in heavy competition for the premium dollar. So the shock of these rises is pretty apparent.

It was not just heated competition that caused insurers in 1984 and 1985 to lose 44 to 70 cents for every $1 of premium written in the general liability and medical malpractice lines. Insurance losses for liability coverage are escalating at an extraordinary rate because recent court rulings have expanded the scope of tort liability.

The expansion of tort liability has led to an increase in the number of situations for which an insurer can be held liable and to which liability insurance will have to respond. The impact of expanded tort liability has already been felt, both by insurers stung by heavy losses and by insurance customers who are faced with higher rates or difficulty in procuring coverage as insurers pass on the prospective costs of insuring risk in an unstable and unpredictable liability system.

We would like to emphasize that the key, we feel, to problems in liability insurance is to return some sense of stability and predictability to our liability system. This is because the insurance system is based on predictability. If you take this away, it becomes very difficult for insurers to price their product.

My colleagues have alluded to some of the judicial misinterpretations of insurance contracts, statutory and common law modifications of the tort system, as well as society's increasing expectation of recovering higher and higher amounts from some deep pocket for virtually every injury. This has taken its toll on predictability of losses.

Other panelists have alluded to the deep pocket syndrome, and I think just by the powers of ordinary observation, one can see that this is taking an effect on our society as a certain lottery mentality that is coming forth.

Beyond the question of tort reform, I think there are questions that the society is going to have to address as a whole as to whether we want a fault-based tort system, as was the traditional case, or whether we want to move to some sort of scheme of compensation where every loss is compensated, regardless of fault. We don't believe that the latter approach is a very good solution. We would like to see a return to more traditional forms of tort law, so that we can regain some predictability in the system of liability, and we think this will, in turn, result in stabilizing rates and making policies more available.

AIA REFORMS

If I may, I will cut through to the kinds of reforms that AIA would agree to support. Fundamental is the restoration of the concept of fault to the negligence system. It is fundamental to the reform of tort law. We strongly support the reform of the liability system to assure that the legitimate victims of others' negligent acts are fairly compensated, but without causing relatively blameless defendants to pick up the tab for something that they did not cause. Specifically, we are supporting efforts for tort reform at the State level in several categories.

Senator HECHT. Please summarize. Your time is up.

Mr. LARSEN. We favor limitation of joint liability to a system based more on several liability, caps on noneconomic damages, abolition of the collateral source rule and, finally, we would support some regulation on contingent fee arrangements. Maybe that will have a beneficial effect, and we won't have frivolous litigation.

I commend the subcommittee for undertaking hearings on this important subject, and we will be pleased to work with you in any way to help achieve a fair and balanced tort liability system.

[The complete prepared statement follows:]

Statement

of

Robert L. Zeman

Assistant Counsel

National Association of Independent Insurers

On the Need for Liability Insurance Reform

Before The

Subcommittee on Housing and Urban Affairs

Of the Senate Committee on Banking, Housing and Urban Affairs

Washington, D.C.

May 15, 1986

In behalf of the National Association of Independent Insurers (NAII), a trade association of more than 480 property and casualty insurance companies, I want to commend you, Senator Hecht, for exploring the causes of and possible solutions to the liability insurance crisis.

There are two essential causal factors that have culminated in the insurance crisis of 1985 and 1986. The single primary cause lies in fundamental inequities within our civil justice system. During the 1970s and 1980s liabilities were expanded by the courts at a tremendous pace, and there was an explosion in the number and amount of damages awards.

A second more immediate factor which sparked the current commercial insurance crisis involves the underwriting practices of insurance companies. Despite expanding personal injury verdicts which were issued during the late 1970s and early 1980s, insurers drastically underpriced their policies relative to the risks they assumed in them. The insurance industry experienced a surge of fierce competition, as insurers competed heavily against one another for premium dollars on which they could obtain interest. For a short period of time, investment income earned by insurance companies on the assets they held countered and actually helped cover up the underwriting losses they incurred due to problems within the civil justice system. Few believed those who said that our personal injury law needed reform.

Gradually direct losses sustained by insurers on the policies they wrote outstretched investment income. Interest rates declined dramatically, while insurers faced expanding liabilities under the policies they wrote just a few years earlier. By 1984, underwriting losses exceeded investment income by 3.8 billion dollars. Throughout the early 1980s the return on net worth for property/casualty insurers moved increasingly below the average rate for Fortune 500 companies. In 1984, our return on net worth plunged below two percent, while the rate for the Fortune 500 was 14.6 percent.

The underpricing of policies, declining investment income, and most importantly, increasing liabilities moved the industry into dire financial straits and resulted in the disaster known as 1984. That year we sustained an underwriting loss of 21.5 billion dollars and an operating loss of 4 billion dollars. The results of 1985 showed no significant improvement in the financial condition of our industry, as we set a new record for underwriting losses (25 billion dollars). These major losses in turn led to a sharp decrease in property/casualty insurers' surplus as well as an increase in the number of insurance company insolvencies.

Faced with these huge underwriting losses and declining investment income, insurers were forced to stop insuring those risks which had become particularly dangerous due to expanded liabilities. The result was severe insurance availability problems for commercial risks in particular.

In the face of adverse economic conditions that developed during the past two years, the insurance industry has taken positive steps to relieve marketplace difficulties. These include participation in the market assistance programs that have been set up in about 30 states, the NAIC Clearinghouse which is similarly designed to enhance availability, and formulation of new policy programs. These actions have already helped relieve insurance shortfalls and will continue to do so. We will, nevertheless, continue to face insurance availability dilemmas for the forseeable future unless and until we get to the root cause of the financial losses I outline for you: fundamental inequities within our civil justice system.

While the insurance shortage was aggravated by the underpricing of policies, the ultimate cause of the crisis lies in our distorted personal injury law. Through the 1970s and 1980s, tort law in the United States was dramatically liberalized. Traditional theories of liability were expanded, and new theories of liability were created. These changes reflect courts' movement towards "no-fault" liability. Historically, personal injury liability was based on a finding of fault. The plaintiff had the burden of proving the defendant breached a duty of care owed to the plaintiff and that the injuries sustained were caused as a direct result of the defendant's wrongful conduct. Today the trend is toward compensating injured parties regardless of fault or causation on the theory that defendants and their insurance companies are better able to absorb the cost of injuries than plaintiffs.

One example of this movement may be found in cases refusing to allow presentation of the state-of-the-art defense, thus making a manufacturer liable for a consumer's injury even though the manufacturer took every precaution that was scientifically and technologically feasible at the time. Another example entails adoption of the market share theory, under which, if the plaintiff is unable to identify the specific manufacturer of the product that caused his injury, every single producer of that type of product is liable for the proportion of the judgment representing its share of the market. This approach causes particular problems where the product is not truly generic in nature or when not all of the relevant manufacturers are accounted for in the litigation.

In addition to expanded theories of liability, we have faced increasing damages awards. The average medical malpractice verdict increased from $220,018 in 1975 to $1,017,716 in 1985. The average product liability verdict during this same period increased from $393,580 to $1,850,452. Finally, the average punitive damages award in personal injury cases in Cook County, Illinois increased from $40,000 in 1970-74 to $1,152,174 in 1980-84.

The collective effect of the trend toward no-fault liability, diminished causation rules and exploding tort awards has instilled tremendous uncertainty and unpredictability into the process of underwriting and pricing liability risks. Assumption of uncertain risks is the very essence of insurance, but insurers do need some legal standards upon which they underwrite those risks. Destruction of predictability in the civil justice system has led insurers to turn away from more dangerous commercial entities, resulting in current commercial insurance availability problems.

Mr. Chairman, you requested our opinion as to the efficacy of user-owned mutual insurance companies. While we do not oppose the movement toward creation of user-owned mutual insurance companies provided they are subject to the full scope of authority of state regulation, such companies offer no real solution to the underlying cause of insurance shortages. It is important to note that several mutual insurance companies set up in the late 1970s in response to the medical malpractice insurance shortage now face severe economic deficits. For example, the Medical Liability Mutual Insurance Company, providing coverage to physicians in New York, faced a shortfall of about $750 million as of the end of 1985 and recently applied for a rate increase of 57 percent. We believe the adverse economic condition affecting physician owned mutual insurers clarifies that problems within our personal injury law, and not the activities of private insurers, have caused the insurance crisis.

It is readily apparent that the distorted civil justice system lies at the heart of the insurance crisis. It is equally clear that reformation of that system is the only way to resolve this problem. The tort reforms suggested in the proposals at issue represent an important step toward restoring insurability to this country's commercial risks.

For example, we agree that the rule of joint and several liability should be totally abolished. Under the current rule of joint and several liability, a negligent plaintiff can recover all of its damages from any one of several defendants, even though that defendant was only partly responsible for the injuries and even if the plaintiff was more negligent than that defendant. The injustice of this doctrine is clear.

There should also be reasonable limits on awards for noneconomic damages. Such damages are impossible to ascertain with precision and are subject to the emotion of the jury. A study by Rand Corporation's Institute for Civil Justice found that limits on noneconomic damages are among the most effective tort reforms.

We support periodic payment of larger awards so as to guarantee that the funds will be available to meet the victim's needs as they arise. Where substantial amounts are awarded for the long-term care of a patient, no guarantee exists that the money will be spent for that purpose. Not only does periodic payment of large settlements and verdicts assure availability of funds during the course of treatment, but it also helps reduce insurance costs as companies paying structured settlements do not have to maintain larger reserves to pay lump sum awards.

Compensation received from collateral sources should also be deducted from any verdict in order to assure that while the plaintiff receives total compensation, no double recovery that unjustly causes further drain on the insurance pool will occur. The purpose of our civil justice system is to make the injured party whole, and not to maximize compensation.

Finally, we support limitations on contingent fees as they ensure that injured plaintiffs, rather than their attorneys, will receive the bulk of their recovery. The forty percent share of awards that is swallowed up by attorney fees and other transaction costs is excessive, and contingent fee standards will help eliminate some of this inequity. At the same time, these restrictions do nothing to impede the ability of plaintiffs unable to fund their own cases from recovering just compensation. The sliding scale approach is of particular merit since the higher percentage fee for smaller recoveries still encourages attorneys to represent claimants with less severe injuries.

STATEMENT OF THE AMERICAN INSURANCE ASSOCIATION

BEFORE THE SUBCOMMITTEE ON HOUSING AND URBAN
AFFAIRS OF THE SENATE BANKING COMMITTEE

CONCERNING

LIABILITY INSURANCE AND TORT REFORM

May 15, 1986

Presented by
William L. Larsen
Senior Counsel

American
Insurance
Association

The American Insurance Association is a national
trade organization of casualty insurers.

PROFILE

The American Insurance Association is a full-service trade organization of casualty insurance companies. In its present form, the association combines three earlier organizations. One of those, the former National Board of Fire Underwriters, was organized in 1866, making it one of the oldest trade associations in the nation.

The various departments provide members with up-to-date intelligence on legislative, regulatory, judicial and technical developments relating to our industry. The AIA also maintains liaison with insurance regulators, federal and state lawmakers, other state and federal government officials, insurance and non-insurance industry groups and media—supplying information and assistance on issues of mutual concern.

A countrywide system of regional offices and local legislative counsel ensures prompt and rigorous attention to casualty insurance matters. At the same time, technical specialists from disciplines as diverse as law, economics and engineering educate members and outside publics on developments that may affect the industry and its services to the insurance-buying public.

The American Insurance Association (AIA) is a trade association that represents 170 property and casualty insurance companies. The member companies of the Association represent approximately 35% of all commercial premiums written throughout the United States. We have been asked to present testimony on the subject of liability insurance and tort reform.

Roots of the Current Problems in Availability and Affordability in Liability Insurance

Put simply, the roots of current problems in availability and affordability in liability insurance lie in the unprecedented losses and rapidly changing operating environment experienced by insurers in recent years.

An explanation of availability and affordability problems must begin with a brief discussion of the financial condition of the insurance industry. Since 1979, property/casualty insurers have suffered ever-growing underwriting losses. In 1985 property/casualty underwriting losses totalled $24.7 billion. Although insurance companies may offset underwriting losses through investment income to achieve positive operating income, investment income has not kept pace with underwriting losses. In 1985, underwriting losses exceeded investment income by $5.4 billion. This record industry operating loss in 1985 followed the industry's previous record operating loss of $3.8 billion incurred in 1984.

With over $9 billion in operating losses in the last two years, property/casualty insurers recently have begun to raise premiums to keep pace with loss costs. Just as insurer losses have been dramatic, in some cases

premium increases also have been dramatic--to the consternation of policy holders used to bargain basement prices. Beyond raising premiums, some insurers have taken such heavy losses in some lines of insurance that they have concluded that the risks in certain classes of business may be uninsurable and have withdrawn from those markets. These actions have caused hardship and inconvenience among some policyholder groups who rely on various lines of commercial liability coverage. As insurers take these measures to regain some control over their wildly escalating losses, in some lines of insurance--primarily general liability and medical malpractice-- policies have become less "affordable" and sometimes less "available" than in the past.

Some critics charge that insurers laid the groundwork for these problems themselves through heated competition and inadequate pricing stemming from the late 1970's. This is not the case, although underpricing did drop premiums well below the level needed to cover loss costs. The "insurance industry" is not monolithic. Even the largest companies have a small portion of the total market share in any single line of insurance. Competition is fierce for the premium dollar in most circumstances. Competition was exceptionally intense in the late 1970's and early 1980's when premiums could be invested for high inflation-driven returns. Insurers were able to reduce the price of their product by balancing underwriting losses with investment income until 1984. Extensive price-cutting benefitted many policyholders. Purchasers of general liability insurance in particular reaped the benefits of lower insurance premiums during this period.

While the intense competition of 1979 to 1984 exacerbated increasingly severe operating losses and thus contributed to availability and affordability problems, other factors were also at work. It was not just heated competition that caused insurers in 1984 and 1985 to lose 44 to 70 cents for every dollar of premium written in general liability and medical malpractice lines. General liability and medical malpractice paid losses have grown 167% over the five year period from 1979 to 1984, an average of 22% a year. That insurance losses for liability coverages are escalating at an extraordinary rate reflects the fact that recent court rulings involving particular legal doctrines have expanded the scope of tort liability. Expansion of tort liability has led to an increase in the number of situations for which an insured will be held liable and for which liability insurance will have to respond. Fundamental changes in the nation's system of redressing tort liability have been under way for a number of years. Their impact on insurers' financial results has already been felt--both by insurers stung by heavy losses and by insurance customers such as local governments, manufacturers and small businessmen who are faced with higher rates or difficulty in procuring coverage as insurers pass on the prospective costs of insuring risks in an unstable and unpredictable liability system.

Existing Problems in Tort Law

Insurers and reinsurers are recognizing that pricing and underwriting expectations for many classes of commercial liability insurance have been rendered unreliable because of the unpredictability of future losses.

Judicial misinterpretations of insurance contracts, statutory and common law modifications of the tort system, as well as society's increasing expectation of recovering higher and higher amounts from some "deep pocket" for virtually every injury, have taken their toll on the predictability of losses. These developments affect virtually all forms of commercial liability insurance, but they especially affect long-tail exposures where the insurer's (and reinsurers') policies can be invoked five, ten, or even twenty years after the policy was written.

The most basic concept underlying insurability and insurance contracts is the concept of risk. "Risk" means literally the "chance of loss" or the "probability of loss." If a loss is certain to happen, then there is no risk of loss to transfer, and an insurance transaction cannot take place. There is a growing perception among underwriters that the accumulation of legal remedies provided under state and federal liability systems are changing a hitherto insurable probability of loss to an uninsurable certainty of loss. Underwriters are attracted to predictability of loss but must avoid inevitability of loss.

The second fundamental concept of underwriting and insurability is that of predictability. If there is no way to forecast the timing or amount of a loss from past experience, then the loss is unpredictable. Any estimate would be pure speculation.

Standard coverage for liability insurance originally applied to bodily/injury or property damage "caused by accident." The accident concept was also the time trigger of coverage and the building block of limits of liability. An individual policy covered only accidents which occurred during the policy period.

The classical accident, as perceived by insurance underwriters and policy drafters, was concrete rather than abstract. They regarded an "accident" as a sudden event of a physical nature that happened by chance at a definite time and place and caused rather obvious injury or damage--a collision of vehicles, a scaffold which broke, a roof which collapsed. "Accident" was not a legalistic concept. The underwriters' conception of "accident" harmonized well with both the classical liability principles of tort law and the fundamentals of insurability. Certainty as to time and place laid the foundation for reasonable predictability.

By 1970, it became apparent that coverage based solely on the classical accident concept was no longer adequate for most insureds. There were true "risks of loss" that did not arise out of sudden causes, but were the result of continuous or repeated exposure to physical causes which resulted in nontraumatic, multiple causation, long-latency diseases.

The extent of exposure for liability insurance coverages has changed dramatically in the past decade. The relationship between low level exposures to useful, but sometimes harmful substances, and injuries to human beings is not well understood today and is still to a large extent speculative. Tort law a few years ago did not concern itself with speculative possibilities of harm. Doctrines of joint and several enterprise liability had not been formulated. It was not until 1974 that the deluge of asbestos-related claims began.

The concept of an accident as a simple scenario involving one person directly or proximately causing another person harm often no longer applies in our complex society. Despite societal changes, however, recent tort law has applied traditional concepts of the simple accident to the multi-faceted modern commercial context.

This approach is inadequate when society is faced with a relatively new problem, such as the mass tort. Mass tort actions have increased steadily since 1977. The mass tort involves a mass repetitive wrong or a wrong that affects numerous person or a community. Mass torts differ from more traditional torts in that: the injuries are often medically complex and have multiple causes which are often difficult to evaluate; injuries can be attributed to earlier exposure to products or toxic substances occuring many years before symptoms were detected; the injury applies to a group or class of persons or in some cases a whole community; and finally, because of the structure of American business and the production of such substances as vaccines, medications and even asbestos or formaldehyde, often it is only a relatively few entities (which sometimes constitute a whole industry) that have been involved in the behavior.

Class actions are emerging as a way to handle claims affecting groups of similar parties stemming from toxic products, defective products or negligent acts. Mass tort class actions have been brought where injury has occurred to a wide variety of people from such substances as DES, the Dalkon Shield, the Swine Flu Vaccine, Agent Orange and Asbestos. In all of these cases, though it is frequently very difficult for a plaintiff to show the direct relations of a particular wrongdoer to his particular injury, the plaintiffs nevertheless have been successful.

Class actions allow certain communities or types of persons throughout the nation, or classes exposed to a risk of harm through commercial enterprises or through certain industries, to redress their harm through the liability system. They frequently have sought to hold entire industries liable for the creation of risk to the public, and, as in the vaccine case, often without regard to the benefits of the enterprise to the public.

The Deep Pockets Report, prepared by the Institute of Civil Justice in 1985, indicates awards differ among types of defendants. Awards against corporate defendants averaged over $120,000 as against awards for individual defendants of $18,500. Where injuries were the same, corporate defendants paid 30 percent more than individual defendants. Notably, governmental defendants, which 20 years ago were protected by the doctrine of sovereign immunity, were subjected to an average award of $38,000.

Certain classes of additional defendants are perceived differently from in the past. For example, the problem of drunk drivers causing an innocent third party's injury has resulted in the expansion of liability to include the provider of the alcohol. Similarly, in the past, everyone understood that some risk was inherent in any vaccine. However, in recent times, law suits have proliferated against vaccine manufacturers. Recent court decisions have created new and unpredictable liabilities for property/casualty insurers. As stated in the Villanova Law Review:

> In two recent toxic tort cases, the highest courts of California and New York have held that liability for injuries allegedly caused by DES can be imposed upon defendant-manufacturers without proof that those defendants made DES which caused the plaintiffs' injury. In Sindell v. Abbott Laboratories (1980), the California Supreme Court accomplished this result by fashioning a "market share" theory of liability. Under this theory each defendant was liable for the proportion of the judgment represented by its share of the DES market unless the defendant could demonstrate that it could not have made the product which injured the plaintiff.
>
> Subsequently, in Bichler v. Eli Lilly & Co. (1982), the New York Court of Appeals affirmed a jury verdict against a manufacturer of DES which was based upon the plaintiff's theory that Lilly, in concert with other DES manufacturers, had wrongfully marketed this drug without proper testing. Under this "concert of action" theory, the court in Bichler found the defendant liable for the plaintiff's injuries even though the plaintiff had failed to prove that Lilly--the only defendant named in the suit--was the manufacturer of the DES that the plaintiff's mother had ingested.[1]

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[1] Villanova Law Review, Volume 28, No. 6, September, 1983, p. 1102-1104.

In both Sindell and Bichler, the rationale underlying the courts' decisions was the same. In both cases, the court was confronted with an innocent victim unable to prove which manufacturer harmed her because of the long latency of the injury coupled with the similarity among the products of the different manufacturers. Faced with a choice between not compensating the victim and holding liable a company which may not have caused the harm, each court chose a theory which would permit compensation of the victim.

Other judicial decisions have weakened defenses based upon the state of the art and technological or economic feasibility. In Beshada v. Johns-Mansville Products Corp. (1982), a manufacturer of asbestos in the 1930's was found to have an obligation to warn of the dangers associated with asbestos products. The manufacturer was not permitted to prove that at the time in question it was not possible to determine the possible harmful effects of asbestos. Prior to this decision, even in strict liability cases, under the state of the art defense no manufacturer would be held liable for harm caused by conduct or products that could not have been anticipated under state of the art knowledge. This novel decision is a particularly significant finding for chemical product manufacturers because they may be held liable even in instances in which the harmful potential of the product was not discoverable at the time.

Rulings of this type dispense with a fundamental element of the tort system--proof that the defendant was responsible for the plaintiff's harm. Such rulings disrupt the reasonable expectations of both manufacturers and insurers concerning the limits of their liability.

Judicial misinterpretations of insurance policies designed to respond to limited types of pollution exposures have created additional concerns among insurers. Recent court decisions have expanded insurance coverage for cleanup of waste treatment, storage and disposal facilities beyond that which the liability policies were designed to provide. Insurers have lost confidence in the words and phrases of art that have been placed in pollution insurance contracts in order to exclude coverages which may be provided in other insurance policies or which may be properly excluded due to the unpredictable or potentially catastrophic nature of the exposures.

The Comprehensive General Liability (CGL) insurance policy is the instrument used to provide the vast majority of insurance protection for commercial entities from liability for bodily injury and property damage. The CGL insurance policy is a contract between the insurer and the insured in which the parties define both the risks covered by the insurance and those excluded from coverages. The premium charged by the insurance company relates directly to the frequency and severity of the risk that the company intends to insure. Courts have elected to misinterpret the insurance policy contract language in order to maximize insurance coverage for damages related to hazardous waste.

Some decisions have gone so far as to rewrite policy terms and create coverage which insurers never intended to provide and for which no premium was ever collected. Specifically, we perceive a trend in court decisions that interpret our standard CGL policy to broaden the scope of intended coverage as follows:

- Narrowing the intent of the owned property exclusion to find liability for damage to an insured's property.[2]
- Overriding the scope of the pollution exclusion so that, for example, well contamination caused by seepage at a hazardous waste site that occurred over a 12 year period was found to be covered despite the policy requirement that coverage be afforded for only "sudden and accidental" pollution.[3]
- Converting the CGL's policy dollar limit per occurrence into a per claim dollar limit.[4]
- Setting aside the definitions of property damage and bodily injury so as to award speculative damages for the possibility of future harm.[5]

The possibility of similar misinterpretations leading to expansion of coverage in the commercial auto policy exists due to the inclusion of the category of damages for "environmental restoration" in the Motor Carrier Act. Many commercial auto insurers have reacted by excluding environmental restoration from their commercial auto policies.

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[2] See for example, Riehl v. Travelers Insurance Co., ___ F. Suppl. ___, Civil Action No. 83-0085 (W.D. Pa., August 13, 1984).

[3] See, for example, Jackson Township Municipal Utilities Authority v. Hartford Accident and Indemnity Company, 186 N.J. Super. 156, 451 A.2D 990 (1982). Waste Management of Carolinas, Inc. v. Peerless Insurance Company, 323 S.E. 2D 726 (Court of Appeals of North Carolina, December 28, 1984).

[4] See Township of Jackson v. American Home et. al., Docket No. L-29236-8 (Law Div., August 31, 1984).

[5] Ayers et. al. v. Township of Jackson, 189 N.J. Super. 561 (Ocean County, April 5, 1983).

Along with this undermining of the concept of fault in tort liability, there is evidence of a trend showing dramatic growth in tort damages awards over the last decade. Although the data is sparse, it suggests that certain types of tort cases are being filed with more frequency than in the past. Moreover, jury awards in certain types of tort cases are increasing, even when adjusted for inflation.

The Institute for Civil Justice found, for example, in its studies of jury trials in Cook County Illinois and San Francisco that:

- from 1960-64 to 1975-79 the number of jury trials in Cook County increased 146% for product liability cases and 137% for medical malpractice cases;
- from the early 1960's to the late 1970's the average malpractice judgment in Cook County increased by 556% from $32,000 to $210,000, and in the early 1970s averaged as much as $370,000;
- from the early 1960's to the late 1970's, plaintiffs' awards in product liability cases in Cook County increased from an average of $143,000 to $377,000;
- the increase in average awards for all cases in Cook County between 1960-64 and 1975-79 was 147%;
- in San Francisco, increases in average awards between 1960-64 and 1975-79 were 413% for medical malpractice and 213% for product liability.

In another study suggesting a trend in rising verdicts, Jury Verdicts Research, Inc. found that the number of verdicts nationwide totalling $1 million or more increased steadily from 27 in 1975 to 401 in 1984.

This data, while limited in scope, tends to confirm the underwriting experience of insurers and reinforce the prospect of a continuing trend toward greater exposure of insurers to heightened tort liability claims in problem areas such as medical malpractice and commercial liability.

These examples of existing problems in tort law touch briefly on the rapid and radical changes that have tranformed the American liability system. The law of torts has changed from a system based on a finding of fault to a system driven by the need to compensate injured persons regardless of fault. This search for compensation is extremely costly. Further, the liability system has been rendered unstable and unpredictable. The cost to insurers and insureds is being felt now. The costs to the general public are mounting. If the apparent trend toward more tort liability cases being brought in pursuit of higher judgments continues, reform of the civil liability system is a necessity if insurance availability problems are to be alleviated.

Reform Recommendations

The American Insurance Association agrees with those who see the restoration of the concept of fault to our negligence system as fundamental in any reform of tort law. We strongly support reform of the liability system to ensure that legitimate victims of others' negligent acts are fairly compensated without leaving relatively blameless defendants liable for harms they did not cause.

Specifically, the American Insurance Association is supporting efforts for tort reform at the state level in several categories. First, the elimination of joint liability is one of the crucial elements for a return to a sound commercial insurance market in the non-personal lines. The effect of the use of the joint and several doctrine in today's tort environment has been to expand the potential for liability of any commercial or governmental unit in a manner which is designed to achieve the greatest compensation to a plaintiff, without regard to the relative degree of fault by the particular business or governmental body.

In the past ten years, joint and several liability has been applied to a variety of commercial and governmental entities which, by acting independently, have contributed to a particular civil wrong or to the occurrence of damages. This application has coincided with changes in other tort doctrines such as the erosion of sovereign immunity, the extension of dram shop liabilities, new types of damages such as those for environmental cleanup, extension of product liability, the general weakening of the burden of proof as to causation and the general trend to provide higher levels of recovery. The net effect is abuse of the doctrine (which originally was allowed only where tortfeasors acted in concert) and the search for the "deep pocket."

The increased use of the doctrine of joint liability has come about because of the drive to compensate often innocent victims. Where injuries and the associated costs are extensive, the probability that the "deep pocket" will be targeted as the defendant increases. (It goes without saying that the "deep pocket" defendant is not necessarily the defendant most at fault.) While the theory of joint liability is operating to provide compensation for some injured parties, it also is operating to cost the taxpayer and the business person significantly. Not incidentally, the doctrine makes it unreasonably difficult for insurers to gauge the risk for which it is insuring a municipality or business.

Accordingly, the American Insurance Association favors abolition of joint and several liability. We favor the concept of several liability with apportionment to other parties and non-parties except employers and co-employees. Under this concept of modified comparative fault, a plaintiff is totally barred from recovery if he or she is 50% or more at fault and the plaintiff's compensation is reduced by the percentage the plaintiff is found to be at fault up to 50%.

As a second reform measure, AIA supports reasonable caps on noneconomic damages. Recovery of noneconomic damages should be distinguished from recovery of objective and quantifiable damages such as lost wages, medical expenses and other economic losses, which we agree should not be limited. Nonquantifiable, noneconomic damages, however, are subjective because it is difficult to place a monetary value on such things as pain and suffering, emotional trauma and loss of companionship or consortium. These awards vary considerably from case to case, resulting in unequal treatment of persons with similar injuries. The economic resources of the defendant also may become unfairly a part of the damage equation. Reasonable caps will encourage greater consistency of treatment by juries of those with similar injuries without depriving injured parties of reasonable compensation for noneconomic damages. Moreover, caps balance the need to compensate injured persons adequately with the need of society to maintain the affordability of goods and services. Caps may help to reduce litigation by narrowing the monetary range of dispute about damages. Further, caps establish an upper boundary of the least predictable element of the damage calculation. Improved predictability, in turn, will have a beneficial impact on the availability and price of insurance.

AIA also supports abolition of the collateral source rule. Under the traditional collateral source rule, juries are unaware that plaintiffs have received or are likely to receive compensation from another source. Eliminating this rule would reduce the cost of tort awards by eliminating double recovery for certain elements of damages, a windfall for plaintiffs that society can no longer afford to permit. Elimination of the collateral source rule also will have a beneficial impact on insurers' ability to predict liability exposures and thus on the availability and price of insurance.

Finally, AIA would support the regulation of contingent fee arrangements. It may be that reasonable regulation of such arrangements will have the beneficial effect of eliminating frivolous litigation.

Conclusion

As we have outlined above, the American Insurance Association believes that only through substantive reform of the civil justice system can we effectively address the cost and availability of liability insurance. As long as the legal system operates to make it difficult or impossible to assess risk, the problems associated with the availability and the cost of liability insurance will/continue and possibly worsen. Tort reform is essential if commercial casualty insurance is to be available at prices the public can afford. The Subcommittee is to be commended for taking an interest in this important subject and AIA would be pleased to work with the Subcommittee in any way to help achieve a fair and balanced tort liability system.

Senator **Hecht**. Thank you. We're running a little bit late, so I am going to give you some questions.

Please address them as fast as you can.

COMPROMISE SOLUTION

Mr. Zeman, you pointed to the distorted civil justice system as the root of the insurance crisis. To be a devil's advocate for a moment, how did you respond to a compromise solution that would cap awards but give the industry predictable risk, and at the same time limit the radical swing of premiums in response to interest rates, giving consumers predictable premiums, predictable risk, predictable premiums? Sounds ideal.

Mr. **Zeman**. It sure does, Senator.

The only problem with that is capping rates or enacting precise limits on rates, ignores the fact that there are so many other factors that go into ratemaking. To turn it around, specific tort reforms will definitely insure that restore predicability and insurability to the insurance business, but there are many other factors that go into rates, in addition to the legal system. There is no doubt, once again, that various tort reforms, when enacted, do help stabilize the market, but to automatically enact tort reforms and then say we are going to cap rates, ignores fundamental procedures within the insurance industry ratemaking process.

Senator HECHT. Thank you. Mr. Larsen, in a letter to me from your association, you state that the expansion of the Risk Retention Act for commercial lines should be limited to States in which a demonstrated need for particular coverage can be made for fear that a corresponding minimally regulated commercial insurance industry develops.

Aren't you really asking Congress to protect your market share in areas where you are willing to provide insurance and to allow competition only in areas where you are not willing to provide coverage?

Mr. LARSEN. Not to sound falsely altruistic, we think there is a need to protect the public from legislation that would set up a parallel unregulated system to a regulated one. There is the case of the Eastern Indemnity Co., which, as I understand it, could qualify under the current Risk Retention Act bill, to have set up business as an insurer, and if they had gone down—well, they did go down, but that case is, I think, an indication of the problems that could result. I don't think the objection is to helping out specific groups, such as nurse midwives or whatever, who are genuinely having problems. Our fundamental objection to the Risk Retention Act solution as proposed by the Senate is that it is a little too broad. It goes too far, and it goes beyond what is necessary to alleviate the problems of some groups.

We think it could just lead to real problems for the general public, should they get hooked up with an unregulated entity.

WEST VIRGINIA DECISION

Senator HECHT. Recently, the West Virginia State Legislature put a cap of $1 million on noneconomic awards in malpractice cases. In addition, the law imposes limitations on the ability of insurance companies to cancel policies.

Soon after the law was signed, the State's five largest insurers sent out notices to 7,000 doctors and 58 hospitals stating that coverage would be canceled by June. As a result, the State Supreme Court issued an injunction to keep the companies from canceling the policies.

Don't you think that a $1 million cap enables insurers to make more sound business decisions? Anyone who would like to answer that. Mr. Farmer.

Mr. FARMER. If I could just respond to that. In the first instance, you need to look at precisely what the West Virginia Legislature did. To simply say they capped awards at $1 million and not to examine the additional requirements that were put on insurers, the inability to get out of that business at a future date, I would suggest, were probably more of the reasons for those insurers to take the individual decision to get out. It has been widely reported that the West Virginia Legislature capped awards, but not too widely reported as to what the particular restrictions on insurers were.

I would submit that that was the reason that those insurers decided to pull out or to not renew the coverage in West Virginia.

Senator HECHT. Thank you. Because of time restraints, we are going to have additional questions for you. We will send them to you, and respond for the record.

Thank you very much. Let's go on to our next panel.

The Reverend Michael McCafferty and George Bernstein.

Reverend McCafferty, I understand you have traveled a long way to get in here. We are very appreciative and anxious to hear from you.

STATEMENT OF REV. MICHAEL D. McCAFFERTY, C.S.C., ASSOCIATE PROFESSOR OF LAW, NOTRE DAME UNIVERSITY

Reverend McCAFFERTY. Thank you. It is good I came on at the end, Mr. Chairman. I was going to apologize for my lateness, but luckily, I didn't have to do so.

I was going to ask if this committee has any jurisdiction over the airline industry. I was going to plead at an early stage.

Chairman HECHT. I was in my State of Nevada over the weekend. I was at Winnemucca. You probably don't get to Winnemucca very much. And I had to speed to get to the airport, only to find out my plane had been canceled.

So I understand what you are talking about.

Reverend McCAFFERTY. At least it wasn't that bad for me today.

My name is Father Michael McCafferty. I am an associate professor of law at the University of Notre Dame Law School and of counsel to the Chicago law firm of Winston & Strawn.

At law school, I teach torts, constitutional law, products liability, medical malpractice and have coauthored a book with a medical doctor entitled "Medical Malpractice: Bases of Liability."

My written statement, which I would ask be included in the record——

Senator HECHT. It will be a matter of record.

Reverend McCAFFERTY [continuing]. Deals with product liability. I would like to begin in a more general sense and refer some of my remarks to some of the things we've heard this morning. We've heard a lot of statistics. Many of those statistics point quite clearly to a very important and ever-increasing problem, if you will, even a crisis. One thing I would urge this committee, as well as Congress, as well as all of our State legislatures, to remember is that whenever we're talking about difficulties in our civil justice system, our tort liability system, and normally that goes to damages, remember that we are talking, apart from the frivolous lawsuit, about people who have been injured—some rather seriously injured and some who have actually been killed and for whom a wrongful death action has been brought. There is no way that these people can be fully and adequately compensated for the injury or the harm that they have suffered.

GOGNIZANT OF THE HUMAN FACTOR

Society makes choices, and society sometimes has to make painful choices. How do we spread out the risks of these losses and these injuries among those who deal with one another in society?

I only raise this so that we don't lose sight, as we fall into somewhat of a mire of statistics, of the fact that we are talking about people, about human beings, who do suffer because of products, because of malpractice or because of one of the other activities or institutions with which they have dealt in this society.

With regard to damages—and this applies, as far as I am concerned, whether it is products liability or medical malpractice that we speak of—I see no difficulty with limiting those damages to economic losses plus some adequate measure of pain and suffering. This is an example of the kind of painful choice that society has to make, or Congress and its legislatures has to make, of which I spoke above.

Beyond that, these statistics really show that punitive damages are not that often awarded. They are very fearsome for those who have to insure against them or those who have to pay for them, but they are not nearly as prevalent as some would have us believe.

The one thing I would urge that Congress not do in the areas in which it does have jurisdiction, is not tamper entirely with the tort system.

I don't believe that the system of civil justice or our tort liability system itself has failed. It has served us very, very well over many, many decades. The principle of our tort liability system is that no one or no institution should be allowed to avoid legal responsibility, that is, liability for his or her misconduct. That is all the civil justice system attempts to do in awarding damages to one or another injured party.

Senator Dodd had a very interesting proposal this morning, and I look forward to seeing it in its entirety. There are many features of it that avoid some of the pitfalls, I think, of Senator Kasten's bill and Senator Danforth's early bill.

One extremely important criterion, I think, to keep in mind in all of the legislation is, that a fault-based system of liability is perhaps the best that has served us. In products liability that means that we should, in all likelihood, return to some measure of fault. At least in our design-defect cases against manufacturers, strict liability seems more appropriate there. With regard to joint and several liability, there are other ways to deal with that particular problem rather than eliminating it entirely.

One of those ways is the Uniform Comparative Fault Act, which does, in fact, carve up on an equity share basis, the respective liabilities of parties.

COLLATERAL SOURCE RULE

With regard to the collateral source rule, I would only say that a distinction needs to be made between public and private sources of collateral assistance to individuals. It seems clear that if it is a public collateral source we are talking about, then there should not be a double-dipping from the welfare system, if you will, as well as the government paying on its own behalf for injury that is caused for by government entity.

If we are talking about private sources, however, that is more problematic. I think that should be left to judicial discretion and determination on a case-by-case basis.

Senator HECHT. Reverend, your time is up.

Would you please summarize.

Reverend **McCafferty**. The one final point I would make is with regard to contingency fees. I think it is time, on a basis somewhat similar to New Jersey or the Federal Government, that there be some system set up for contingency fees reaching a percentage limit when they go beyond recovery of a certain amount. I will leave it at that point.

[The complete prepared statement follows:]

guson should be repealed, both the Justice Department and the FTC have looked at it and laughed at it.

They said it's patently absurd that this is the most competitive industry they've seen in years. Competition is what caused those losses. We didn't hear State regulators. We didn't hear trial lawyers complaining about the rate bargains they were getting for 5 years.

What is happening is that rates are finding their proper level. Unless we reform the tort system, rates are going to increase and availability is going to decrease, and there is no way out of that.

It's as easy as anything in the world. I would like also to submit to the committee testimony that I gave in New York in February on the banking issue.

Senator **Hecht**. Thank you. It will be made a part of the record.

[The following was subsequently submitted for the record:]

The Need for Uniform
Federal Products
Liability Legislation

Statement by:

Rev. Michael D. McCafferty, C.S.C.
Associate Professor of Law
University of Notre Dame Law School

To:

Subcommittee on Housing and
Urban Affairs
United States Senate Banking Committee

May 15, 1986
Washington, D.C.

I. THE NEED FOR UNIFORM FEDERAL PRODUCTS LIABILITY LEGISLATION.

The lines are clearly drawn for the highly significant tort law battle surrounding the issue of preemption of state products liability law through federal legislation. "No one can seriously argue that the patchwork of product liability laws in the United States is not in need of reform," said Senator Robert W. Kasten (R-Wis.), the author of one of the primary efforts at federal legislation in this area.[1] "Consumers and manufacturers alike are suffering from the present archaic and costly system," Kasten stated. "If we had uniform national rules to cover product liability, we could better guarantee uniform justice for all our citizens."[2] On the opposite side of the battle are opponents of uniform legislation who react angrily to rhetoric such as that espoused by Senator Kasten. An attorney for "Congress Watch", the legislative arm of Ralph Nader's public citizen organization, labeled the prospect of uniform federal legislation "outrageous" and, referring to the organization's preference for the present system of state products liability laws, stated that, "[w]e like the fact that judges make the law, because judges can change it. In Congress, there are the millions of dollars given by the manufacturers on one side, and on the other side there are the victims."[3]

The mood of the United States, as reflected in a general anti-big government bias, seems rather poorly suited to the advocacy of federal reform tampering with the present tort law system which has traditionally been the almost exclusive domain of the several states. However, despite the seemingly hostile political climate and the general opposition of the organized bar,[4] a large segment of the legal community, leaders of business and industry, and members of Congress support federal products liability reform, viewing it as desirable and essential.[5]

Indeed, after several years of intense scrutiny of the products liability system, three presidential administrations, two federal task forces, the Senate Commerce Committee and a growing number of legislators and legal scholars have all concluded that the present products liability tort litigation system impacts significantly and adversely upon interstate commerce.[6] Specifically, the huge increases in products liability insurance premiums, the scarcity of insurance coverage in certain industries, the failures of small businesses, the chilling effect on new product development and the disincentives created for producing safer products have all been characterized as the results of the current products liability system. In short, a tort litigation system which results in more money going to attorneys and claims investigators than to injured claimants can hardly be perceived as a fair and just method for resolving product-related disputes.[7]

The two principal causes of the excessively high products liability transaction and insurance costs have been identified as overly subjective insurance ratemaking procedures and the uncertainties inherent in the present tort litigation system. While the problem of overly subjective ratemaking procedures has been

solved by the enactment of the Product Liability Risk Retention Act,[8] the problem arising from the uncertainty and unpredictability of the product liability tort litigation system remain.

The uncertainty and unpredictability of the system are the result of several interrelated factors. The evolution of products liability law from both contract and tort law is one source of this problem. In many states, persons injured by products may sue on contracts theories, such as breach of warranty, and also on tort theories of recovery, such as negligence and strict liability. This mixture of legal theories has resulted because traditional common law doctrines were deemed inadequate to resolve modern products liability disputes. The mixture of the two incompatible doctrines raises serious conceptual problems for courts and claimants regarding, for example, the nature of recoverable damages or the applicability of the statute of limitations.[9]

An additional source of unpredictability and uncertainty is the fact that products liability law is, for the most part, the common law offspring of judges and juries sitting in state courts.[10] As a result, applicable rules vary from state to state and often from case to case within a state. Manufacturers are exposed to varying standards of liability and lack clear guidelines by which to conform their conduct. While over thirty states have enacted some form of products liability statute, most are not comprehensive and fail to address many critical issues which typically arise in products liability litigation. As a result of these legislative shortcomings, judges have been forced to develop rules retrospectively on a case-by-case basis without the benefit of legislative hearings and investigations which are able to examine the products liability problem in its entirety.[11] Injured plaintiffs may find that, due to restrictive rules in the state in which they bring suit, they are at a disadvantage in their effort to recover for product-related harms compared to citizens of other states. This ad hoc, case-by-case and state-by-state approach to products liability rights and remedies is unfair and very costly to all concerned.[12]

A third source of unpredictability and uncertainty in the products liability tort litigation system is the conflicting philosophies about the purposes and functions of product-related tort law, especially as to the nature and application of strict liability in tort. Under the traditional view, strict liability is limited to cases alleging a construction defect or breach of an express warranty. Some states have attempted, however, to extend it beyond its prescriptive purpose and have applied it in design and warning defect cases where there is no objective measure for determining whether a defect exists.[13] Stated differently, according to one school of thought, manufacturers should be liable only when they are at "fault" in producing a defective product. Others, however, take the position that manufacturers' should bear the risk of all product-related injuries and essentially become insurers of their products. That these philosophical differences should be addressed in a legislative forum rather than by judges forced to mix common law theories seems quite

clear.[14] The result of the present system, as stated above, has been the development of uncertain and unpredictable legal standards, differing from state to state. The uncertainty and unpredictability of approaches adopted by the various courts applying state law are brought into clear focus by two relatively recent decisions construing New Jersey products liability law.

The decision of the Supreme Court of New Jersey in Beshada v. Johns-Manville Corp.[15] illustrates how far the process of judicial "social engineering"[16] with regard to products liability law has gone. In Beshada, where the plaintiffs complained of Manville's failure to warn of the hazards of asbestos, the court rejected Manville's state-of-the-art defense that distributors of products can be held liable only for injuries resulting from dangers that were scientifically discoverable at the time the product was distributed. The court concluded that it would be in the public interest to impose liability in a case like this, regardless of whether the hazard could be known, because "if a product was in fact defective, the distributor...should compensate its victims for the misfortune inflicted on them,"[17] and because "the manufacturers and distributors of defective products can best allocate the cost of injuries resulting from them."[18]

The ramifications of the Beshada decision, which on its face imposes absolute liability for failures to warn, will reach beyond New Jersey products liability law. The uncertainty created by the possibility that other jurisdictions might follow Beshada and by the possibility that other products, long after their actual manufacture, will be found to present dangers which could not be discovered or warned of poses a serious threat to products liability insurers who must reflect their potential exposure in setting nationwide rates, as well as to manufacturers that are self-insurers, as they attempt to create appropriate reserves.[19]

The decision of the Third Circuit in Dawson v. Chrysler Corp.,[20] in which the court applied the products liability rules of New Jersey in a defective design case illustrates the uncertainty and unpredictability of the products liability tort litigation system and the unfairness of applying the rules of an individual state to a nationally marketed product.[21] In Dawson, the court upheld a jury verdict that Chrysler was strictly liable for injuries sustained by a police officer when the car he was driving crashed into a steel pole. The jury held that the car was defectively designed because its frame was not sufficiently strong to withstand side impacts. The evidence introduced at trial, however, proved that the design complied with all federal automotive safety standards and that the frame exceeded federal protection standards for most types of accidents. The Third Circuit, in affirming the jury verdict, expressed "uneasiness" with the consequences of allowing "individual juries in the various states...to establish national automobile safety standards."[22] The court stated:

> In effect, this permits individual juries applying varying laws in different jurisdictions to set nationwide automobile safety standards and to impose on automobile manufacturers conflicting requirements. It would be difficult for members of the industry to alter their design and production behavior in response to jury verdicts in such cases, because their response might well be at variance with what some other jury decides is a defective design. Under these circumstances, the law imposes on the industry the responsibility of insuring vast numbers of persons involved in automobile accidents.23

For manufacturers needing products liability insurance to cover potential exposure and those seeking to provide for self-insurance, Dawson means that any and all such arrangements are likely to become more costly, and for those who seek to counsel manufacturers on the design of products or the adequacy of warnings, there is the haunting prospect that hindsight will inevitably expose flaws in foresight.[24] Full compliance with federal health and safety standards may be of little relevance. Indeed even the question of whether an injury was caused by one's own product or the product of another manufacturer has become quite blurred in some states.[25] For all concerned, products liability law has become increasingly unpredictable and highly variable from state to state. The entire scenario has evoked the observation that the situation is so bad that only the lawyers can reap any benefit from it.[26]

The current splintered products liability tort system has placed an "albatross" around the neck of our interstate commerce and it would appear to be a burden which cannot be eliminated by individual state action. Because products are sold in an interstate market and may result in injury in any of a number of states, the enactment of a comprehensive product liability statute in one state cannot alleviate the problem. Product manufacturers and sellers in that state will still be unable to predict

Senator **Hecht**. Thank you very much. Mr. Bernstein.

STATEMENT OF GEORGE K. BERNSTEIN, ESQ., ATTORNEY AT LAW

Mr. **Bernstein**. I am testifying today not on behalf of any particular client, although I am very much involved in the availability and pricing issue. You have asked me to testify today, because of my background, both as a State regulator and Federal insurance administrator, also someone who represents the New York City Housing Authority and, therefore, has seen this problem.

Senator **Hecht**. And you are knowledgeable on this subject.

Mr. **Bernstein**. I would say that you have probably just about all the conclusions you need to hear or would want to hear.

TORT EXPLOSION

I would just like to summarize what I think they really are. The problem from all sides, I believe, is the tort explosion. The problem is that we no longer have fault in the fault system, and the fact that the misconduct that Father McCafferty talked about has been read out of the tort law and the fault law on too many occasions by too many judges in increasing numbers over recent years.

As a result, we have moved to a situation where the choices, again, that Father McCafferty talks about have been made for us by our unelected judges, and they have imposed on us by juries, sympathetic to injured parties, through an entitlement system, where, as Senator McConnell stated this morning, every injury under the system is going to be remedied. Regardless of fault, you look for the deep pocket and out of sympathy, insurance can pay. Therefore, we are going to remedy that injury. Insurance is nothing more than reimbursement of underlying causes, and if, as a society, we want every injury to be reimbursed, then we shouldn't be sitting around here, we shouldn't be sitting around the State halls complaining about the cost of insurance and the unavailability of insurance.

If we pay for everything, rates are going to go through the ceiling. Any insurance company that insures toxic tort, for an example, any insurance company that doesn't up its prices significantly for the liability system today is out of its mind and is irresponsible to its stockholders, its policyholders, and its solvency. And whether we are talking about raising prices significantly or not, we are talking about raising those prices to protect against future losses.

We are not talking about recouping the losses that were incurred because insurance company competition over the many years from 1979–84, those losses are lost forever.

State insurance law in every State prohibits recoupment, and the increase in rates is to avoid future losses. If those rates had risen on a gradual basis, they would still be as high today, with this year's premium, as they would have been, as they are, without the increases in rates. There is no recoupment. That was confirmed by the Justice Department in its recent tort study.

As to the concept of conspiracy, the idea that insurance companies have gotten together to avoid business and that McCarran-Fer-

and reasonably insure against potential risks, and the statute would be of little or no help in providing for the citizens of that state the advantages of a stable and uniform products liability law.[27]

Many states have adopted new products liability legislation in an effort to reform the common law system. Although over thirty states have enacted some form of products liability statute in recent years and although the merits of the various statutes have been debated at length by the legal community, no one has seriously suggested that these reforms have led to certainty in the tort litigation system.[28] Most of these state statutes are less than comprehensive and few address the most important and troubling issues of products liability law, such as the standards of responsibility of product manufacturers for construction and design defects.[29] The available evidence suggests that, rather than solving the problem, the individual state efforts have merely served to exacerbate the problem of uncertainty[30] and to underline the need for a federal legislative solution.

The first problem with the various states' products liability statutes is that there has been no general agreement regarding which problems require statutory solutions. Many differing legislative approaches have been adopted. The most popular reform is probably the "statute of repose," adopted in at least twenty-two states.[31] Another statutory reform, adopted in at least seven states, creates a defense based upon modification or alteration of a product by the consumer or user.[32]

A second problem with the state statutes arises from the fact that once a particular statutory solution is chosen, there is no agreement among the states as to the specific terms of the legislation.[33] The statutes of repose serve as an excellent example of this problem. These vary widely in length from six to twelve years. Some create a rebuttable presumption that a product is not defective after a certain number of years while others create an absolute defense. In addition, these statutes may or may not apply to actions in negligence and warranty.[34] The net result of these and other variations "has been to exacerbate...the wide disparity in legal principles which govern the outcome of products liability lawsuits depending upon the jurisdiction in which they are brought."[35] As a result, "[s]tate legislation of this sort is liable to lead to a jungle of anomalous and complicating provisions."[36]

Other types of legislative reform vary greatly from state to state. Regardless of the specific approach taken by the various states, minor variations in substance and phrasing in the state statutes compound the uncertainties fostered by the basic dichotomies. As one commentator suggests, "[i]nsurers, manufacturers, and injured consumers--who would take solace in increased certainty of products liability law--will not find much comfort in the present state-by-state-legislative reforms."[37]

In 1979, the Carter Administration attempted to resolve these uncertainties in the products liability tort litigation system at the state level through the promulgation of the Model

Uniform Product Liability Act (UPLA).[38] Since the UPLA was proposed, it has not been adopted in full by any state and, as set forth above, even the states that have enacted limited product liability legislation have failed to address significant issues which frequently arise in product liability litigation. Whether selective or comprehensive, each individual state's law, even if based on the UPLA, varies from that of other states and cannot cure the critical lack of uniformity that currently plagues the system.[39]

Realistically, it was misleading to suggest that the UPLA would be accepted and adopted by the states. This is because individual states lack the incentive to enact comprehensive products liability legislation as a result of the fact that only a small percentage of products manufactured within a state are ultimately consumed within that state. Thus, consumers within a state do not benefit by certainty in the law of their state because the products they consume continue to reflect the costs of uncertainty in other states.[40] A clear example of the states' disincentive to enact legislation is embodied in a statement made by Kansas Governor John Carlin in vetoing a state products liability bill:

> Current economic data indicates that approximately 90% of the products manufactured in Kansas are purchased out of state and a similar percentage of goods used by Kansans are manufactured in other areas. Consequently, unless a law is passed on the federal level,...only a small number of Kansas business owners could benefit from the special protections contained in the bill. Yet, all Kansas consumers would be subject to the limitations for recovery.[41]

The fact that the distribution of products is performed on a national level cannot be overemphasized. Thus, individual states have not and cannot satisfactorily resolve the uncertainties inherent in the products liability tort litigation system, either through case law or statute. Federal legislation is necessary and appropriate to reduce and resolve the present uncertainties while, at the same time, equitably articulating the rights and responsibilities of all concerned groups.[42]

The more serious and pertinent questions confronting Congress today are not whether federal legislation in this area is called for. Rather, they are which issues can and should be appropriately addressed at the federal level, and what should be the precise shape and substance of the federal legislation. Because the ultimate effectiveness of federal products liability legislation depends on the content of the statute itself, the goals which Congress should seek to achieve through this legislation need to be clearly formulated.

The legislation should first seek to remedy the problems inherent in the present state by state system of products liability law, as set forth above. The federal statute must create certainty and predictability as to the responsibilities of the parties involved by clarifying applicable legal standards. The federal statute must make clear who a plaintiff can sue in the distribution chain, when they can be sued, and for how much. In addition, the statute should clearly delineate the defenses available to a defendant and the conduct by a plaintiff which will preclude him from recovery.[43]

In addition to creating certainty and stability, a federal statute must address other needs as well. First, to be equitable to all parties, the federal legislation must fairly balance the interests of manufacturers and product sellers with those of consumers because for a federal statute to be favorably accepted it must geniunely reconcile the conflicting interests of consumers in obtaining compensation with the interests of manufacturers in avoiding absolute and unlimited liability.[44] Next, because a defective product can cause great harm, federal legislation should supply incentive for manufacturers to produce safer products and for consumers to utilize greater care when using the products they purchase. Congress should also clearly and simply define the statute's terms so that juries unfamiliar with legal terminology can effectively evaluate evidence, which in products cases can itself be exceedingly complicated, under the statutory standards.[45] Certainty and predictability in the law is essentially contingent upon these goals. If the law appears unfair and ambiguous, judges will be reluctant to uniformly and even-handedly apply the statute and fears of non-uniform interpretation will become substantiated realities.[46]

The bottom line is that, in addition to the goals stated above, federal products liability legislation should be short, simple and highly focused. It should ideally draw from recognized areas of national consensus for its standards and should, at every juncture, adopt the least intrusive alternative so as to minimally upset the traditional role of state courts in controlling tort litigation.[47] Initial attempts at uniform legislation appear to have stalled as a result of excessive complexity. By proposing to deal with the entirety of tort law as it affects product liability litigation, the bills have created enormous interpretive problems. It is simply impossible to compress the entirety of the law of torts into 15-20 pages of legislation.[48]

The solution to the product liability dilemma is not to rewrite the law of torts, but to target specific problem areas that are unique to product liability litigation and to seek to resolve them as simply as possible so as not to spawn layer upon layer of textual complexity that will inevitably confuse the law for the foreseeable future.[49] If such an approach is adopted, the preemption provisions of the legislation will not speak to the entirety of products liability litigation, but only to those issues which are directly covered by the statue.[50]

II. THE AUTHORITY OF CONGRESS TO ENACT UNIFORM FEDERAL PRODUCTS LIABILITY LEGISLATION.

Among the objections that have arisen with regard to the enactment of a uniform federal products liability statute is the argument that if a statute were to be enacted, it might be declared unconstitutional. This argument should not, however, act as any kind of substantial impediment to the adoption of such federal legislation. Although the constitutionality of a federal product liability law would depend, at least in part, on the content of the statute at issue, the authority of Congress to enact such a statute almost certainly exists and there is substantial reason to foresee that a properly drafted federal tort reform proposal would pass constitutional muster.[51]

Opponents of federal products liability reform have suggested that such reform would violate equal protection by singling out one part of the common law tort system for change. Any statutory measure in this vein, however, would be assessed under the "rational basis" standard of equal protection review, rather than under the "strict scrutiny" standard. It seems clear that the establishment of uniform products liability law is rationally related to the legitimate governmental purpose of trying to resolve problems created by the present multiplicity of state laws and the uncertainty which results.[52]

Opponents of the legislation have also suggested that a uniform statute might violate due process. This argument also fails in that it is well established that a statute depriving either plaintiffs or defendants of common law remedies or defenses does not per se violate due process.[53] Rather, the test is whether the statute bears a reasonable relationship to the permissible goals that it is designed to further.[54] It is clear that a federal products liability statute would meet this standard and bear a reasonable relationship to the permissible goal of creating uniformity in the presently uncertain and unpredictable products liability tort litigation system.

With regard to the issue of Congressional authority, the Commerce Clause empowers Congress to enact such a statute through its grant to the federal government of the right and responsibility to regulate and promote interstate commerce.[55] The present uncertain and complex system of state common and statutory products liability law hampers trade among the several states and exemplifies the rationale underlying the Commerce Clause: to permit a uniform approach to resolving issues that impair the conduct of business and trade across state lines.[56] That virtually every product sold today is a product in interstate commerce can hardly be denied and the power of Congress under the Commerce Clause to regulate interstate and intrastate activities that affect interstate commerce is well settled.[57]

The federal interest in guarding interstate commerce has, in the past, spurred Congress to formulate uniform federal solutions to problems involving interstate commercial activity. Proponents of federal products liability legislation point to several federal statutes which have preempted areas of state tort law as statutory precedent for federal products liability legislation.[58] Although the federal government's intervention in tort law has been a "piecemeal" approach, it is clear that federal intervention has occurred in areas where the traditional tort litigation system was perceived to be inadequate at addressing problems of national significance.[59]

The reality that tort law has traditionally been a matter of state law does not lessen Congressional authority under the

Commerce Clause to promulgate a federal products liability statute. Products liability is an interstate commerce issue rather than a states' rights issue and, consequently, the assertion that local products liability laws should be retained because the tort system has traditionally been a creature of common law needs to be weighed against the burden imposed on interstate commerce by the uncertain and unpredictable standards of the present products liability system.[60] The need for federal legislation in this area certainly outweighs the need to honor the traditional but unworkable system presently in place.[61] Thus, it is clear that there are no constitutional impediments to the enactment by Congress of a uniform federal products liability statute.

ENDNOTES

1. R. Smith, "Uniform Product Liability Law--But on Whose Terms?" Calif. Law., Jan. 1985, p. 34

2. *Id.*

3. *Id.*

4. A summary of the ABA's position can be found in Sevier, "Federal Product Liability Act," 11 The Brief 3 (1982).

5. O. Reed and J. Watkins, "Product Liability Tort Reform: The Case for Federal Action," 63 Neb. L.Rev. 389, 390 (1984).

6. M. Coccia, "Uniform Product Liability Legislation," Ins. Counsel Journal, Jan. 1984, 104, 117.

7. *Id.*

8. Product Liability Risk Retention Act 15 U.S.C. §§3901 *et. seq.* (Supp. V 1981).

9. B. Bares and V. Schwartz, "Federal Reform of Product Liability Law: A Solution That Will Work," 13 Cap. U.L. Rev. 351, 354 (1985).

10. *Id.* at 354-55.

11. Coccia, *supra* note 6, at 118.

12. Bares and Schwartz, *supra* note 9, at 355.

13. *Id.*

14. Coccia, *supra* note 6, at 119.

15. 90 N.J. 191, 447 A.2d 539 (1982).

16. T. Atkeson and G. Neidich, "A Status Report on Proposals for a Federal Product Liability Act," 38 Bus. Lwyr. 623, 624 (1983).

17. 90 N.J. at 204, 447 A.2d at 546.

18. 90 N.H. at 205, 447 A.2d at 547.

19. Atkeson and Neidich, *supra* note 16, at 625.

20. 630 F.2d 950 (3d.Cir. 1980), *cert. denied*, 450 U.S. 959 (1981).

21. Atkeson and Neidich, *supra* note 16, at 625.

22. 630 F.2d at 953.

23. 630 F.2d at 962.

24. Atkeson and Neidich, *supra* note 16, at 626.

25. *Sindell v. Abbott Laboratories*, 26 Cal.3d 588, 607 P.2d 924, *cert. denied*, 449 U.S. 912 (1980).

26. Atkeson and Neidich, *supra* note 16, at 626.

27. Bares and Schwartz, *supra* note 9, at 354.

28. Reed and Watkins, *supra* note 5, at 420.

29. Bares and Schwartz, *supra* note 9, at 355.

30. Reed and Watkins, *supra* note 5, at 420.

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.* at 421.

35. *Id.*, citing, Note, "The Proposed Product Liability Statute in Ohio--Its Purpose and Probable Results," 29 Clev. St. L.Rev. 141 (1980).

36. *Id.*, citing S. Waddams, *Products Liability* 252 (1980).

37. *Id.*

38. The text of the Act and commentary found at 44 Fed. Reg. 62,714-50 (1979).

39. Bares and Schwartz, *supra* note 9, at 355.

40. Coccia, *supra* note 6, 118.

41. Message by John Carlin, Governor of Kansas (April 24, 1980).

42. Coccia, *supra* note 6, at 119.

43. "The Products Liability Crisis: A Federal Statutory Solution," 1983 Ill. L.Rev. 757, 769-70 (1983).

44. *Id.* at 770.

45. *Id.*

46. *Id.*

47. A. Twerski, "National Product Liability Legislation: In Search for Best of All Possible Worlds," 18 Ida. L.Rev. 411, 418 (1982).

48. *Id.* at 469.

49. *Id.* at 470.

50. See "Product Liability Voluntary Claims and Uniform Standards Act," S. 1999, 99th Cong., 1st Sess. (1985), section 103.

51. Reed and Watkins, *supra* note 5, at 466.

52. *Id.* at 467.

53. *Id.* at 467-68, citing *N.Y. Central R.R. v. White*, 243 U.S. 188, 202 (1917).

54. *Id.*, citing *Ferguson v. Skrupa*, 372 U.S. 726, 730-32 (1963).

55. U.S. Const. art. I, §8, cl. 3.

56. Bares and Schwartz, *supra* note 9, at 357.

57. *Id.*, citing *Wickard v. Filburn*, 317 U.S. 111, 125 (1942).

58. e.g., Federal Employer's Liability Act, 45 U.S.C. §51-60 (1982); Longshoremen's and Harbor Workers' Compensation Act, 33 U.S.C. §§901 *et seq.* 1978).

59. Coccia, *supra* note 6, at 114.

60. Bares and Schwartz, *supra* note 9, at 358.

61. *Id.*

guson should be repealed, both the Justice Department and the FTC have looked at it and laughed at it.

They said it's patently absurd that this is the most competitive industry they've seen in years. Competition is what caused those losses. We didn't hear State regulators. We didn't hear trial lawyers complaining about the rate bargains they were getting for 5 years.

What is happening is that rates are finding their proper level. Unless we reform the tort system, rates are going to increase and availability is going to decrease, and there is no way out of that.

It's as easy as anything in the world. I would like also to submit to the committee testimony that I gave in New York in February on the banking issue.

Senator HECHT. Thank you. It will be made a part of the record.

[The following was subsquently submitted for the record:]

TESTIMONY OF

GEORGE K. BERNSTEIN

On Behalf Of The

AMERICAN INSURANCE ASSOCIATION

Before The

NEW YORK STATE SENATE
NEW YORK STATE ASSEMBLY
COMMITTEES ON BANKS

In Opposition To
Allowing Banks to Engage in Insurance Activities

New York City
February 27, 1986

My name is George K. Bernstein. I am an attorney practicing in Washington, D. C., and New York City. I have been involved in insurance regulation and issues of solvency, pricing and availability for 27 years. During that time, I have served as a New York State Assistant Attorney General handling the litigation and appeals of the New York State Insurance Department, as Deputy Superintendent and General Counsel and then First Deputy Superintendent of the New York Insurance Department, and as Federal Insurance Administrator.

I am appearing on behalf of the American Insurance Association ("AIA"), a trade association representing 177 insurers writing all lines of property/ casualty insurance.

AIA opposes implementation of the recommendations of the New York State Temporary Commission on Banking, Insurance and Financial Services, known as the DeWind Commission. Those recommendations are not in the interest of insurers, insurance agents or brokers and most importantly, are not in the interests of the consumer public of the State of New York.

Your Committees have heard extensive testimony for and against the legislation implementing the DeWind proposals, but I believe none so comprehensively deals with their defects as the Dissent of Alfred S. Howes, one of the DeWind Commissioners. As counsel to Mr. Howes during the Commission study and report, I was involved in the preparation of the dissent and I commend it to you for a detailed analysis of why the Commission recommendations are fatally flawed and not in the public interest. I submit a copy of that dissent for the record.

Although I will discuss why, some two years later, events have proved the dissent to be more valid than ever, I will first address myself to the concern of the legislature with current problems of insurance availability in certain lines, and whether "banks in insurance" offers any solution.

Following the increasing number of bank insolvencies, acknowledged and covert, since the DeWind report, few would seriously consider granting banks additional powers beyond those they have proven incapable of exercising.

Accordingly, the banks have sought to use the liability crisis that has affected both the price and availability of insurance as a smokescreen behind which they would achieve in New York State expansion of powers already denied them at the federal level.

The banks have been almost cute about it. They don't promise to write toxic waste, asbestos, medical malpractice, municipal liability, dram shop, chemical company and other liability insurance lines that have been hit by the deep pocket syndrome and increased tort payments. But the banks do imply that if only they were allowed to bring their "vast resources" to bear on the problem, somehow coverage would be found for these risks at prices that would please everybody.

Nonsense! The Legislature should not be deluded into believing that the insurance availability problems in New York or anywhere can be solved by banks. In fact, many banks are facing their own insurance availability problems because of the manner in which they have conducted their own business and the likelihood of lawsuits and judgments resulting from their behavior.

The liability insurance crisis affects only about seven percent of the insurance written in the United States. Automobile, fire, homeowners, workers compensation, commercial multiple peril and most lines of insurance are readily available at prices that are not significantly higher than several years ago.

It is only in the so-called general liability and medical malpractice lines, where the ever increasing search by plaintiffs' lawyers and the courts for the deep pocket has produced an explosion of judgments and settlements that has made these lines almost uninsurable, that availability problems exist. In the other lines, competition for business remains active and prices reflect the desire of insurers to write this business.

Does anyone really believe that banks will insure our toxic waste dumps?

Does anyone really believe that banks will insure product liability risks when even those industries that obtained Congressional permission to form their own risk sharing pools have been afraid to touch the risk?

Does anyone really believe that banks will insure day care centers against child molestation?

Does anyone really believe that banks will insure the whooping cough vaccine?

Does anyone really believe that banks will insure bar owners?

Does anyone really believe that banks will write Directors and Officers' liability insurance for anyone but themselves when their own exposure to such liability is growing daily because of bad loans and other irresponsible activities?

And does anyone really believe that banks will insure against medical malpractice, particularly when the doctors and hospitals who have sought to do so themselves are going broke?

Of course not. These lines are not being avoided by insurers because they are good risks. Even if banks were suddenly to acquire the necessary underwriting expertise, they are no better able to sustain the losses from such coverage than are insurance companies.

Given the economic climate that banks as well as insurers are operating in today, the traditional separation between banking and commercial activities is more important today than it has ever been. It is foolhardy to believe that banks will be able to measure their exposures to these risks any better than the insurance industry. Even if banks were willing to expose themselves to uninsurable risks, even if they could somehow find the financial capacity to write such coverage when they are having trouble keeping themselves afloat, permitting them to indulge in such recklessness would be an invitation to disaster.

Insurance companies have not raised prices so drastically on certain risks or avoided them altogether because they want to give up good business and lose money. Insurers are in business to write insurance and make a profit by accepting risk. The income necessary to pay claims comes from both the premiums received, which are set at a level expected to cover future losses and expenses and a reasonable profit, and from investment income.

After suffering a record pre-tax loss of $3.8 billion in 1984, and what would have been a $5.5 billion loss in 1985, except for the industry's unprecedented sale of capital assets and use of tax loss credits, property/casualty insurers have had to face the reality that their continued survival depends on underwriting only those risks for which premiums can be set high enough to protect against potential financial catastrophe. Where expected losses on a particular line of risks can not be measured with any degree of accuracy, those risks become uninsurable and responsible insurers will not cover them. To do otherwise would endanger policyholders and shareholders.

The lines of insurance that today face availability and/or affordability problems, general liability and medical malpractice lost 52 cents and 70 cents, respectively, for each dollar of insurance written in 1984, and the general liability premium increases that were required over the last year reflect the incredible bargains consumers received from 1979 to 1984 when total premiums received were less at the end of the period than at the beginning.

Just two days ago the Governor's Advisory Commission, established to investigate the availability problems in liability insurance, reported that day-care insurers experienced a 2,000% increase in losses in New York State but only a doubling in premiums in the four years ending in 1984; that New York municipalities had almost no change in premium volume over the same four year period but a 200% increase in losses; that public schools in New York experienced a 500% increase in losses during this period but only a 200% increase in premiums; that non-profit agencies in New York recorded a 200% rise in losses during this period but only a 50% increase in premiums; that nationwide commercial losses rose by 240% over this period but premiums increased by only 150%, and that New York State experience reflected the national trend.

Even with emergency contributions of capital from parent corporations, these losses have significantly reduced the surplus of insurers and thereby reduced the capacity of the industry to accept risk. Insurers are directing their existing capacity to lines of insurance where there is a likelihood of profit, not where losses are guaranteed. Does anyone expect that banks will act any differently with whatever capacity they have available to write insurance?

Ordinarily, the idea of bringing new entrants into the insurance marketplace and thereby alleviating availability or affordability problems would be a welcome one. The current problems facing insurance consumers, however, do not stem from an unwillingness on the part of insurers to provide insurance on risks that can reasonably be insured. Nor are these problems susceptible of quick fix solutions that address only the symptoms and not the underlying causes.

Those risks that are not being written by insurers will continue to be uninsurable unless and until the liability system is reformed so as to restore the function of the insurance mechanism to one of risk-bearing rather than that of a deep pocket where every loss is expected to be remedied regardless of the existence of fault.

New York, through the Legislature, the Governor's Advisory Commission and the Insurance Department, is currently studying this crisis. Until it develops a solution that deals with root causes there is no way that insurers or banks can avoid financial ruin if they write such coverage.

Given the losses insurers have suffered in these lines of insurance and the severe financial problems many banks are facing -- there were a record 120 U. S. bank failures in 1985, following 79 failures in 1984 and 48 in 1983 -- authorizing banks to underwrite and sell insurance in return for their promise to accept risks for which no accurate projection of expected losses can be made would constitute flagrant disregard for the safety and soundness of New York's banking system, as well as a total lack of concern for the well-being of the citizens of this State. It would not even be in the interest of the banks and it would certainly be disastrous for their depositors. Who will have to make good on the unpaid insurance promises of the banks?

Even with respect to insurable risks, the recommendations of the New York State Temporary Commission on Banking, Insurance and Financial Services are wrong. The Commission was created to study the "structure and dynamics" of the financial services industry in New York State and to recommend changes in the legislation and regulations that govern financial service institutions in the State. The Commission was specifically directed by the Legislature to evaluate "the extent to which the public interest would be served by such changes."

Unfortunately, a majority of the Commission chose to ignore or disparage the testimony of consumers who voiced their deep concerns with banks becoming too powerful and of insurance agents who provide personal service to the residents of New York and of other members of the public regarding the coercive lending powers of banks.

Among those who testified about their concerns for the long-term interests of consumers was United States Senator George Mitchell, of Maine, who has witnessed the unsuccessful high-pressure efforts of the banks to obtain Congressional approval for the repeal of federal restrictions on their insurance activities. Senator Mitchell testified to his concern not just with the future of the independent insurance agency system if the banks received the authority recommended by the majority, but also to his fears for the interests of the insurance purchasing public.

Evidence was also presented by witnesses who independently researched the problems consumers face when banks are authorized to sell ancillary products or services to borrowers. The Commission chose to ignore or mischaracterize as "personal or anecdotal" such testimony on problems consumers are faced with when banks have been permitted to do an insurance business, but the testimony was detailed, specific and offered a comprehensive history of bank overreaching.

The testimony of the Iowa Insurance Commissioner, Bruce Foudree, past President of the National Association of Insurance Commissioners, was particularly revealing, but it was also ignored by the majority. Iowa permits banks to engage in insurance sales activities in order to meet the needs of those people living in rural areas where there is an availability problem. Iowa also has a statute prohibiting the coercion of debtors by banks. Commissioner Foudree testified, however, that despite the statutes prohibiting debtor coercion and tie-in sales, Iowa still has a "significant problem" with such abuses and that "it is difficult to enforce because for practical purposes it is extremely hard to prove a debtor coercion case." Thus, he said, the problem "has continued to occur in my home state."

Similarly, the majority chose to overlook the testimony of Dr. Irving Plotkin of Arthur D. Little, Inc. Dr. Plotkin presented historical examples of what happens when banks are permitted to engage in insurance agency activities. The case of Title Insurance Company of Minnesota ("Minnesota Title") was particularly apt. Minnesota Title was doing 81 percent of the title insurance business of Twin City Federal Savings and Loan when, in March 1979, the savings and loan bought a 52 percent interest in a small title insurance company.

Within a period of approximately one year, the proportion of the business going to Minnesota Title dropped from 81 percent to 9.8 percent. On the other hand, the small title company increased its share from 12 percent to 83.3 percent despite the absence of complaint about the prices charged by Minnesota Title or the quality of its service. Regardless of the fact that an 80 percent market share is unfortunate whoever controls it, the ability of a lender owned insurer to reverse the market so completely, in so short a time, is evidence of the coercive power of banks and thrifts.

The Commission's record is rife with examples from witnesses of banks turning the competitive marketplace on its head when authorized to sell insurance ancillary to the extension of credit, despite the fact that such coercive tie-ins are currently prohibited by both state and federal law.

This coercive power cannot and has never been prevented by laws, regulation or greater supervision. It is impossible to avoid the perception on the part of a consumer seeking a loan that purchasing insurance from the lender might create a more favorable impression, and this is true regardless of

whether the explicit solicitation precedes or follows the granting of the loan. Since they are much more interested in receiving the loan, borrowers will almost never complain about how they were forced or urged to purchase high cost insurance. As Dr. Plotkin testified, although the individual charges are not overwhelming, they add up to massive profits to the banks: "People are not being hurt very much, they are only being clipped a little bit, fifty dollars, or a hundred dollars a piece." These are and will continue to be helpless "clipees", at the mercy of the banks.

The Federal Reserve Board, itself, has frequently acknowledged that lending institutions have the capacity to control the decisions of many borrowers as to the source of insurance they purchase in conjunction with extensions of credit. In testimony before the Senate Banking Committee, the Board stated:

> "Because of the inferior bargaining position of the debtor, he may be susceptible to the loan officer's 'suggestions' concerning choice of coverage, premium rates, insuror and agent. As a result, the debtor easily may receive the impression that his loan application may be more favorably considered if he follows such suggestions."

The perception on the part of borrowers that they have a much better chance of receiving the loan if they buy their insurance from the lending institution is equally applicable to both individual and business borrowers. As vital as are bank loans to individuals, they may be even more essential to the survival of businesses, particularly small businesses, many of whom have no more sources of credit with which to bargain than do individuals.

Even if new insuring capacity seems at first glance to be desirable, it is readily apparent that banks are no more able than insurers to write uninsurable risks. With respect to other lines of coverage, hundreds of insurers are competing vigorously on price and service to an extent unknown in the banking area, as evidenced by price variations and market share. There is no need for new capacity in these areas, which represent more than 90% of property/casualty insurance.

It is ludicrous, given the banks' record of disdain for the consumer, to believe that further grants of authority will encourage them to change their stripes and better serve the community, or will bring a quick fix solution to basic problems in the liability system in New York State and elsewhere.

Mr. **Bernstein**. I would like to say with respect to the idea that banks, any more than insurers are going to underwrite uninsurable risks, the idea that banks are going to write toxic tort coverage, is absolutely absurd.

RISK RETENTION

It is not going to happen. Also, with respect to risk retention, the Risk Intention Act is an interesting temporary solution, but it's not going to solve anything in the long run. You may authorize risk retention groups to make insurance available, but that insurance is going to have to be at the price that reflects the risk or you're going to have insolvencies and innocent third parties are going to be the losers—whether it's a risk retention group, whether it's a medical malpractice mutual, whether it's a captive rate, it must reflect risk or else losses will occur to the extent of causing insolvencies and innocent third parties will be the victims of those insolvencies.

You've heard of the various areas of tort reform that have to be corrected. I'm not going to go into it at this point. I would point out that you could repeal McCarran-Ferguson tomorrow. It wouldn't make one more policy available, or lower risk one more dollar.

As the Justice Department says, the very people who are criticizing the competition, the excessive competition of the early 1980's, to say repeal McCarran-Ferguson to get more competition, is, quote, "patently absurd."

So I will conclude by merely pointing out that insurance reflects the underlying cost of the product. Unless we have the courage in this country to make the difficult choices as to whether or not we want to curtail what that underlying cost is, we have no right to complain about the unavailability of insurance, whether it's for housing authorities or anybody else.

[The complete prepared statement follows:]

During the five days of hearings held by the Commission -- amazingly brief as a predicate for such radical proposals -- no evidence other than self-serving statements of various bankers was presented to justify the majority's conclusion that the authorization of new and unprecedented power to sell and underwrite all types of property/casualty and life insurance would offer any benefits to consumers.

In its effort to support the conclusions, the majority failed to acknowledge the warnings of various federal officials such as Chairman Volcker of the Federal Reserve, then Secretary of Treasury Regan and former Chairman of the Federal Deposit Insurance Corporation (FDIC), Issacs, against fragmenting the federal system of bank regulation by permitting the states to get into a bidding contest for bank business. Detailed comments of these officials are contained in the attached Howes Dissent.

Unable to cite any evidence of how new insurance powers for banks would benefit consumers, the majority was content to offer generalized statements of principles and ivory tower theories of competition to buttress its recommendations. The Commission failed to distinguish between abstractions and the real world.

Unlike the insurance industry where insurers, agents and brokers are free not only to succeed but also to fail, the banking system does not operate in a truly competitive environment as to either pricing or survival. Bank regulation

is predicated on the principle that the American people will never tolerate the costs of failure in the banking industry.

Because the public places a high premium on a stable banking system that avoids the personal losses and economic dislocations that would result from the failure of these institutions, Congress has combined to impose restrictions against banks entering other areas of commerce. The key public protection in the event that preventive measures proved inadequate and banks and thrift institutions fail, is the creation of federal insurance for depositors. Since the DeWind Commission report, we have seen even more evidence of the lengths to which Federal bank regulators will go to avoid liquidating an insolvent bank, and the increasing burden placed on deposit insurance. It is the public that pays for such financial disasters whether or not they result in actual takeover by the federal government or in bailouts to prop up insolvent banks.

In stark contrast to the federal insurance mechanism that insulates the public from bank failures, insurance companies have no such protection, nor do policyholders. Because insurers operate in a truly competitive environment where there is a real possibility of failure, in which event other insurers pay a part, but not necessarily all, of the claims of the insolvent company. Accordingly, unlike banks, insurers can not minimize the risk of engaging in either other businesses for which they are not trained and have no expertise, or in the inherently risky business of insurance, itself.

In recommending broad insurance powers for banks, the majority on the DeWind Commission ignored fundamental regulatory questions involving integrated corporate structures. Will the FDIC be responsible for paying off depositors of a bank that failed due to catastrophic losses incurred by its insurance subsidiary? If the FDIC finds that a bank failed because of its insurance activities and does honor its pledge to depositors, will the state insurance guaranty funds be responsible for reimbursing the FDIC? Will such guaranty funds and the insurers funding them, already pressed with the impact of more than 40 insurer insolvencies in the last two years, survive such an interrelated web?

To consider the questions arising from a possible interrelationship of banking and insurance, one need only examine the spectacular collapse of the Continental Illinois Bank and Trust Company. If Continental Illinois had owned a healthy and profitable insurance subsidiary, that insurance subsidiary would have likely been dealt a fatal blow. As Walter Wriston, the former Chairman of Citicorp, a leading proponent of banks-in-insurance, admitted in testimony before Congress:

> "It is inconceivable that any major bank would walk away from any subsidiary of its holding company. If your name is on the door, all your capital funds are going to be behind it in the real world. Lawyers can say you have separation but the marketplace is persuasive, and would not see it that way."

The problems that led to the collapse of Continental Illinois in 1984, the thrift crises in Ohio and Maryland in

1985 and the record number of bank failures in 1985 are the result, in most instances, of mismanagement and fraud. The primary refrain heard after these debacles has been that the banks should have stuck to their last. In fact, they didn't even do a good job at their own business.

As a consequence of the unprecedented number of failures, the Federal Savings and Loan Insurance Corp. (FSLIC), the entity that insures individual deposits in savings and loan institutions, is under "enormous strain", according to its Chairman, Edwin J. Gray. Whether it can survive anticipated additional failures is a matter of grave doubt and concerned debate today in Washington.

Even the FDIC, acknowledged to be in much better financial condition than FSLIC, has suffered severe losses recently. The FDIC has estimated that the bailout of Continental Illinois will cost the agency over $1 billion. As a result, the Senate Banking Committee is currently examining possible ways to strengthen both the FSLIC and the FDIC but no solutions have yet emerged. Some observers question whether these insuring agencies could survive another major bank failure and the domino effect that could cause. Some ascribe the failure to take action against at least one major U. S. bank to such fear.

Although the DeWind Commission majority ignored the preventive and protective features that make banks "special", and the resulting obligation of banks to the public as custodians for much of the nation's liquid savings and as lender of last resort, Congress has repeatedly refused to repeal the federal prohibition against banks engaging in such commercial activities as insurance underwriting or marketing that has existed for more than 120 years. This, despite the most intense lobbying that Congress has seen in many years. In fact, Congress and the Federal Reserve Board have given every indication that the concerns that led to enactment of the National Bank Act in 1864, the Bank Holding Company Act (BHCA) in 1956 and the 1970 Amendments to the BHCA are even more legitimate today, and they are holding fast against caving in to the type of demands encompassed in the recommendations for New York State by the DeWind Commission.

As recently as August 1, 1985, the Federal Reserve Board, acting in response to a request by Citicorp to acquire the American State Bank of Rapid City, South Dakota, denied approval of the application on the ground that:

> ". . . the primary, if not sole, purpose of the proposed acquisition is to permit Citicorp to engage through (the) Bank in various insurance activities that are impermissible for bank holding companies under section 4 of the (Bank Holding Company) Act."

Citicorp has not appealed the decision of the Federal Reserve, and there is no expectation that Congress will grant the banks any new insurance authority in the forseeable future, let alone authority to write the lines of insurance currently experiencing availability and/or affordability problems. If anything, the federal government appears to be more concerned than ever with the safety and soundness of this country's banking system, and rightly so.

After the record number of liquidations and distress mergers in 1985 as a result of bank failures, the federal government is moving away from deregulation toward more regulation and supervision of commercial banks and thrift institutions. Examples of this increased regulation include:

- The announcement by the Federal Reserve Board, the Comptroller of the Currency and the Federal Deposit Insurance Corporation that banks will be required to increase their ratios of equity capital to loans from 6 percent to 9 percent;
- The Federal Reserve Board's decision, due to increasing concern about the rising levels of debt on corporate balance sheets, to limit the use of speculative high-yield certificates in hostile takeovers; and
- The ongoing study by the Comptroller and the FDIC on ways to inject federal money into troubled banks to prop them up, in exchange for partial ownership and control of the banks -- an approach used with Continental Illinois.
- Disciplinary actions by the Comptroller, including cease and desist orders, fines against directors, and removals of bank officials, have increased fivefold since 1980.
- The examination process by the Comptroller has become more adversarial.
- The FDIC added more than 300 examiners and more than 1200 employees to its liquidation staff in 1985.

- The Federal Home Loan Bank Board adopted new regulations in 1985 that restrict the rate of deposit growth of thrift institutions and limit the kinds of investments they can make. The Board is also considering a significant increase in required capital levels.

Although large banks, in particular, continue to seek new powers, Congress or the federal bank regulatory agencies will not take the risk in acceding to their demands. With the recent sharp drops in oil prices it appears that those banks with large energy loan portfolios could be under even more stress for some time. FDIC Chairman William Seidman has predicted that there could be just as many bank failures in 1986 as there were in 1985.

Even without the sword of massive failures hanging over the banks, their track record under deregulation is enough to warrant rejection of the DeWind Commission proposals.

New York Senator D'Amato and Congressmen Biaggi and Schumer have testified before Congress that bank deregulation has been a failure from the consumer's point of view. The cost of services to the consumer doubled between 1978 and 1982 and an outraged Congress has had to address the fact that banks have ignored the continuing drop in interest rates, and have kept interest charges on credit cards at 18% and 19% to produce a profit margin of some 10.5%.

In rejecting the ill-conceived proposals of the DeWind Commission, the Legislature should also consider the economic cost to New York State from the resulting dislocations if banks are granted the powers they seek.

As of 1983, there were at least 165,000 people employed directly by insurance companies, agents and brokers. An additional 82,000 were employed in support industries that rely on the existence of insurance companies, agents and brokers, including public adjusters, lawyers, accountants, and others, and additional men and women are employed in other industries dependent on non-insurance related sales to insurance industry employees. Conservative estimates are that 25 percent of the total number of insurance industry employees could lose their jobs as a result of bank authorization to engage in insurance marketing, alone. In such circumstances, New York State would lose over 40,000 jobs. If banks were given underwriting authority as well, a total of 100,000 insurance jobs could be lost.

Particularly in the economic climate facing banks, this is not the time to indulge their desires to enter new and risky areas. The New York State Legislature as well as the Superintendent of Banking should be taking all necessary action to assure that banks do not engage in high risk activities when they have not proven themselves capable of performing the basic activities for which they are chartered. It is the function of the Banking Department to assure the solvency of banks and the deposits of their customers rather than indulge the whims of bankers who believe that the grass is greener elsewhere.

Testimony Of

GEORGE K. BERNSTEIN

Before The

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
SENATE COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS

On

THE LIABILITY CRISIS AND ITS IMPACTS ON INSURANCE

Washington, D. C.

May 15, 1986

My name is George K. Bernstein. I am an attorney practicing in Washington, D. C., and New York City.

You have asked me to testify today on the need for liability insurance reform. I have had the privilege of testifying before this Committee for the last 17 years, and I am honored that you have again sought my opinion.

I have been involved in insurance regulation and issues of solvency, reserving, coverage, pricing and availability for 29 years. During that time, I have served as a New York State Assistant Attorney General from 1957 to 1961, during which time I handled the litigation and appeals of the New York State Insurance Department, as Deputy Superintendent and General Counsel and then First Deputy Superintendent of the New York Insurance Department from 1964 to 1969, as the first Federal Insurance Administrator from 1969 to 1974. I also served as Interstate Land Sales Administrator from 1972 to 1974.

In my practice, I represent insurers, state insurance regulators, and the largest public housing authority in the United States. I have thus seen the impact of the tort-liability system on insurance pricing and availability from all sides.

To the extent that insurance prices have recently increased significantly in some lines and that coverage is unavailable in others, it is because of the escalation of the deep-pocket syndrome and skyrocketing jury awards that have assessed liability without regard to fault or negligence.

Cities and other municipalities and their instrumentalities have been particularly hard hit as their premiums have risen sharply, and in many instances, coverage has become unavailable at any price.

As long as insurance is the mechanism by which jury awards and resultant settlements are indemnified, the price and availability of insurance will rise to reflect the underlying cost. If the cost is so great or so uncertain as to preclude reasonably accurate pricing, coverage will be unavailable.

There is nothing particularly complex or arcane about this process. Insurance reflects the cost of what it insures.

It is largely because judges, juries, trial attorneys and professional consumers ignore this reality, however, and act as if the cost of liability awards is funded from some vast cornucopia, that a derivative insurance crisis exists.

It is because the public, particularly purchasers of liability insurance, are awakening to the fact that escalating awards mean escalating premiums -- and that they pay for these excesses -- that the trial lawyers who live off the tort system have been forced to look for a scapegoat, to divert attention from the real cause of the crisis.

The current approach of the trial lawyers is to blame insurance cost and availability problems on the intense competition that characterized the insurance business from 1979 to 1984. This argument is inconsistent with the basic contention of these deep-pocket advocates that what is really needed is more competition among insurers, and as the Justice

Department stated in its recent report on the price and availability of insurance, is "patently absurd."

Unquestionably, competition was intense during this period, and in fact, the total premiums charged for general liability insurance in 1984 were less than in 1979.

Did the trial lawyers and their cohorts who now criticize that competition and the consumer bargains it produced argue against those rate reductions when they occurred? Of course not!

Were insurance purchasers demanding that insurers charge them more money? Of course not!

Were Congressmen, state insurance regulators and other officials calling on insurers to raise their rates and charge insureds higher premiums? Of course not!

The trial lawyers' true motivation in seeking to shift the blame for the current crisis to insurers is to protect their contingent fee stake in the liability system and to force insurers to continue coverage that would further enlarge the deep-pocket and increase attorneys' fees.

The motivation of the professional consumerists who -- ignoring the interests of real consumers who have to pay for the costs of the liability system through ever increasing insurance prices -- reject an insurance system based on causation, is to avoid any tort reform that would curtail a judicial entitlement system that currently tends to compensate every injury from an insurance pot, even in the absence of fault.

Insurance prices today are a direct result of this entitlement approach. They are not related to losses, however severe, sustained by insurers as a result of the intense competition of 1979 to 1984. Those losses will never be recouped, and current insurance pricing is not an attempt to do so. Even if they wanted to, insurers are precluded by state rating laws from recouping past losses.

Insurers are required to set premium rates based on past as well as prospective loss experience, and that is exactly what they are doing. It is the projection of the experience gained in incurring past losses that has led to significant increases in certain insurance prices and reduced the availability of other lines of coverage.

As the Justice Department's Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability makes clear, "such losses are sunk costs which the industry cannot recoup by charging higher premiums."

If insurers were charging higher premiums to make up for their past losses, the relative ease of entry for new property-casualty companies, as well as the competitive nature of the business, would assure the availability of the same insurance at a lower price, and insureds would self-insure or form captives to take advantage of the 'excess profits' allegedly available.

The recent Federal Trade Commission study, The Role of Collective Pricing In Auto Insurance (November 1985), the

1977 report by the Justice Department's Task Force on Antitrust Immunities, and the 1979 report by the National Commission for the Review of Antitrust Laws and Procedures, all confirmed the competitiveness, ease of entry and lack of market concentration that typify the property/casualty insurance industry.

As the latest Justice Department report points out:

> "...If premiums in fact are higher than the insured risks and the currently available investment return dictate, either other sources of capital (including insurers who have suffered no losses or lower losses) should offer the same insurance at a lower price, or insureds will retain these 'excess profits' for themselves through self-insurance or the formation of captives. The fact that there appears to be little insurance coverage being made available by new or expanding underwriters, and that many insureds are highly reluctant to self insure or form captives (even though many with serious availability problems may have no alternative), strongly indicates that recoupment of losses is not a particularly compelling explanation for the current insurance availability/affordability crisis."

Insurance costs today do no more than reflect the effort of insurers to properly price risks they are now writing so that they will not incur massive losses in the future.

Thus, even if consumers had not had the incredible bargain in insurance prices that they enjoyed over the recent five year period, current insurance prices would be just as high as they are today!

And it is only in certain lines that the pricing and availability issues exist. These are, essentially, general liability and medical malpractice insurance, which accounted for less than 7% of the property/ casualty premium volume written in the United States in 1984.* Liability coverage for municipalities and public housing authorities falls within these troubled lines.

Other lines such as automobile, homeowners, workers' compensation and commercial multi-peril insurance are still available at premiums not significantly higher than in prior years, although these other lines are not immune to the impact of the liability explosion, and if solutions to the deep-pocket syndrome are not implemented, availability and pricing problems in these areas can also be expected to develop.

Moreover, the pricing and availability problems that we face today would exist regardless of insurer capacity and the impact on surplus caused by the severe operating losses incurred by the industry in the last two years -- more than $9 billion for 1984 and 1985.

No matter what capacity is available, insurers have learned that they cannot survive by writing bad business or by writing other risks below cost.

After five years of intense competition, they learned this lesson the hard way. In 1984 and 1985, investment income did not even cover underwriting losses. Even after realized capital gains and tax credits, net income in 1984

was only $1.3 billion for a return on net worth of 1.7% as compared to 10.9% for all industrial companies and 13.6% for the Fortune 500 companies. In 1985, net after tax income, including realized capital gains, was only $3.5 billion for a return on net worth of just 3.8%, some 10 percentage points below the Fortune 500 companies.

For those insurers writing primarily commercial coverages and for reinsurers, the experience was even worse, as they experienced a negative return on net worth of 3% and 10% respectively, in 1984. 1985 numbers showing such breakdowns by lines of insurance are not yet available.

In 1985, alone, insurers had to obtain new funds of $7.7 billion, and in many instances, individual insurers required these funds to stay afloat.

Overall, in 1984 and 1985, the industry suffered an underwriting loss of $1.18 and $1.16, respectively, on every dollar of premium it wrote, and in general liability and medical malpractice during this period such losses ranged from $1.50 to $1.66 for every dollar of premium received.

The recent testimony of the General Accounting Office* ignores these losses and their distribution, and is misleading when it states that in 1984 the medical malpractice and general liability lines "could have broken even with smaller

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* General liability and medical malpractice premiums in 1984 accounted for $8.25 billion. Total property/casualty premiums in that year were $118,166,000.00.

* Statement of Johnny C. Finch before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, April 28, 1986.

increases in premium rates than the rate increases presently being *reported in the media*."

First of all, the average premium increase charged by the insurance industry in 1984 was only 14.3%, *less than* the 20% the General Accounting Office said was warranted. The GAO has no figures indicating what it guesses the industry should have increased medical malpractice rates by in 1985.

Secondly, insurers are prohibited from setting rates so that one sub-class of business subsidizes the losses of another sub-class. Thus, for example, rates for obstetricians cannot be reduced by raising rates for internists beyond what their own experience warrants.

Even if every state's insurance laws did not require that insurance rates be not unfairly discriminatory and be sustainable on the basis of the experience of the particular line of business, the competitive nature of the industry would never permit the cross subsidization that the GAO endorses by its lumping of all malpractice experience.

That is why, although the overall 20% increase in medical malpractice premiums for 1984 called for by GAO is actually *higher* than the 14.3% increase the industry actually received, the statistical data cited by GAO is irrelevant as to how particular medical malpractice risks are priced.

Similarly, GAO is also wrong in its analysis of general liability experience and premium increases. In addition to its ignoring of the various lines and sub-lines of general liability insurance such as product liability, municipal

liability, toxic waste coverage and the myriad of other lines, GAO bases its so-called analysis on "rate increases *presently being reported in the media*," and makes no investigation or findings as to what increases were actually imposed.

In fact, GAO is again careless and fails to inform that the 1984 price increase charged by the industry across the board for general liability insurance was only 14.4% -- *far lower* than the 29.8% average increase GAO itself estimates was warranted for that period.

The General Accounting Office also chooses to ignore a basic element of ratemaking such as loss development in attempting to minimize the industry's losses, but insurers are required by every state insurance department to follow statutory accounting principles. Those principles require that loss development data be taken into account in setting rates so that reserves adequate to pay for incurred losses and expenses can be established.

Reserve requirements as well as the other elements of statutory accounting exist to ensure the solvency of insurers, and any relaxation of such requirements will come at the expense of insureds and third party claimants. As the recent Justice Department report states:

> "...It would be difficult to justify relaxing reserve requirements, however, in light of the fact that both insurance company insolvencies and the number of insurance companies reported to be in financial difficulty have increased substantially in the last two years."

It would appear that GAO was more interested in criticizing the insurance industry -- not surprising in view of its long-running effort to deny insurers the benefit of reserves for tax purposes -- than in doing a thorough and meaningful study of the current tort crisis.

Insurers have, in fact, sustained massive losses in the general liability and medical malpractice lines, and, not to recoup these losses, but to avoid future losses on business currently being written, they are increasing prices in some classes and avoiding others altogether.

It would be irresponsible for insurers not to respond to the lessons of these losses.

While the trial lawyers and their apologists in the professional consumer movement attempt to belittle this experience by claiming that these losses include incurred as well as paid claims, and policyholder dividends, that is the basis on which all insurance is transacted and on which every insurance department evaluates premium rates, examines its insurers, and determines their financial condition. It is the basis on which some 50 insurers have been placed in receivership and liquidated in the last two years.

Incurred but not yet paid losses are real losses, and paid claims are meaningless to measure the industry's profitability. For anyone allegedly knowledgeable in insurance to ignore incurred losses in calculating the industry's financial condition is simply dishonest.

A paid loss approach would also be news to all the insurers who were ever liquidated as they would not have been insolvent if only paid claims were taken into consideration.

In fact, even if paid claims are evaluated, they prove that the insurance industry has consistently underestimated, rather than overestimated, its incurred liability.

Industry critics like to focus on what they characterize as the previous loss cycle -- 1976. What they try to ignore, however, is what happened to reserves set up at that time.

As of year-end 1976, reserves for all property/casualty claims incurred as of that date were set at $47.1 billion (this included not only the current crisis lines of general liability and medical malpractice, but all property/casualty lines).

By year-end 1984, the industry had already paid out $48.6 billion on these pre-1977 reserves and had been forced to set up an additional $8 billion for these same claims, for a new total of $56.6 billion.

Thus, the 1976 reserve figure was almost $10 billion or 20% deficient. So much for the merit of contentions that the industry overreserved and that paid loss figures would show a more realistic picture.

Although increases in losses over time as a result of tort law expansions are not unique, and have been cited by insurers as a danger for a number of years, and although many insurers actually stopped writing certain lines as a result, they never previously had to deal with the blatant rape of their assets that has evolved in the last few years.

What insurers are faced with today, and what impels them to increase premiums in some lines and avoid writing in others are changes in the tort system that have produced an unpredictability of risk and a guaranty of high future losses.

In efforts to find a deep-pocket to make the injured party whole, even in the absence of negligence, the courts have increasingly utilized such weapons as:

- strict liability and the elimination of the requirement of causation, as a result of which fault and responsibility are no longer a factor;
- joint liability, where a party only minimally at fault is responsible for the total losses caused by others, and under which insurers no longer insure only the activities of their own insureds but also others over whom neither they, nor their insureds, have any control and from whom no premium dollars are received;
- elimination of state of the art defenses, so that conduct, totally appropriate when taken, is found questionable and subject to financial penalty years later, on the basis of ex-post facto judicial legislation;
- judicial repeal of municipal immunity, generating liabilities that were previously non-existent;
- punitive damages, as a windfall award, without regard to the extent of the actual injury suffered;
- unlimited pain and suffering awards, again, without regard to the actual injury sustained;
- maximization of coverage, by creating a pot of insurance coverage from insurers on different risks or on the same risk at different times, regardless of which insured was at fault, or when; this also results in massive discovery costs, as insurers are forced to fight among themselves to determine the responsible carrier;

- frivolous claims, encouraged because of the absence in the American system of any requirement that losing parties pay the winners' attorneys' fees and costs; even in the few instances where such provisions are on the statute books, it is rare that a court enforces the provision;
- the contingent fee system which encourages the law suit lottery.

These developments, while affecting property/casualty insurance generally, have been most felt in general liability and medical malpractice, specifically with respect to the risks of municipalities, toxic waste, day care centers, product liability, directors' and officers' liability and bars.

Insurers' reaction in these lines is not just the result of massive increases in average jury awards such as in the product liability area where they jumped from $345,000 in 1974 to 1,246,000 in 1983 -- a 260% increase -- or in medical malpractice where the increase over the same period was from $166,000 to $954,000 -- a 475% increase.*

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* The trial lawyer faction, fronted by alleged consumerists, quibbles about whether the median liability jury award has increased as precipitously as the average award, attempting to obscure the fact that the total dollars paid out on account of questionable causes of action have skyrocketed.

Nor is it only the result of the drastic increase in the number of product liability cases filed in federal courts, from 1,600 in 1974 to 13,500 in 1985 -- a 750% increase.

Nor is it only the result of the number of million dollar judgments, which jumped from 24 in 1974 to 400 in 1984 -- a 1500% increase.

It is also the result of the consideration given in the claim negotiation and settlement process to what courts and juries are doing, particularly in awarding judgments that are based on absurd and laughable premises.

Although relatively few cases go to trial and most of those where payment is made are settled, those settlements reflect the insurance companies' claims examiners' appreciation of what would likely occur if the case went to trial. If a claims examiner knows that a court awarded $10 million based on a relevant fact situation that might previously have been expected to result in a judgment for the defendant, he will be more likely to settle a case that he would not otherwise have settled, or to settle for a higher sum than he would have if he saw a pattern of traditional tort law being followed.

Thus, when the trial lawyer proponents ask that we ignore what they characterize as "anecdotes," they are asking that we ignore reality. These are actual case histories that demonstrate jury sympathy overcoming logic and common sense and they become precedents and predictors of excesses to come. Any claims examiner who ignores them in his settlement negotiations does so at his own peril and at the risk of his company's assets.

It is these settlements, agreed to by insurers to avoid even greater losses after trial, including the potential of punitive damages, that help drive up the total amounts paid on account of liability policies, and which require either increases in premiums for similar risks taken on in the future, or total avoidance of such risks.

And yet the trial lawyers and professional consumerists profess that there is no "litigation explosion". They now cite a "Preliminary Examination of Available Civil and Criminal Trend Data in State Courts for 1978, 1981, and 1984", produced by the Court Statistics and Information Management Project, National Center for State Courts in April 1986.

This study purports to find only a slight increase in total tort case filings in state trial courts during the period 1981-1984. What it fails to point out is that total tort cases are a misleading number as the bulk of these are auto liability cases, which do not represent a major problem.

This "Preliminary" study also fails to address the 260% increase in average product liability awards from 1974 to 1983, the 750% increase in federal product liability cases from 1974 to 1985, the 1500% increase in million dollar awards from 1974 to 1984 -- and it even ignores the data from the recent New York State Commission on Liability Insurance, which shows that overall tort statistics are relatively meaningless as they include, in a state such as New York, auto liability filings which make up 47% of all tort case filings.

The New York study, which definitely shows the existence of a "litigation explosion", finds that:

- Auto filings declined 5% in the past two years.
- Medical malpractice claims increased 10.9% from 1983-1985.
- All other tort filings increased 9.9% during this period.

Thus, after factoring out tort filings for automobile liability, which is not a current crisis line, the "Preliminary Examination" actually is evidence that a crisis does exist in other liability lines.

The "Preliminary Examination" also ignores the countrywide insurance data that shows that product liability claims filed from 1980 to 1983 increased by 35.6%, an annual increase of 10.7%, that personal injury awards increased at an annual average of 15.23% over the last ten years, and that claim losses in commercial liability insurance increased by 25% in 1984 to 43% in 1985 -- hardly a sign that there was no "litigation explosion".

The report, which purports to rely on state court data, also ignores the following evidence of a "litigation explosion":

- Data from New York City, which is self-insured, and where no pro-insurance bias is even possible, that show that claim payments increased more than five-fold, from $23 million in 1978 to $118 million in 1985.
- Data from physician-owned insurance companies that show that lawsuits have risen from a national average of 12.2 claims per 100 physicians in the late 1970's to 20.3 claims per 100 physicians in 1984.

- Data from a study by the International City Management Association that show that the percentage of public officials being sued increased more than 70 percent in the first half of the 1980's from the last half of the 1970's.
- Data from the Wyatt Company that show that the percentage of companies reporting directors and officers liability claims more than doubled in 10 years.
- Data from a recent study conducted by economists at New York University that show that between 19.7 percent and 26 percent of all liability premiums earned in 1984 were spent by plaintiffs and defendants to resolve disputes, that the cost of adjusting and litigating these claims is between $15 and $20 billion a year, and that these costs could total $199 billion over the next four years -- more than the current annual national debt.

Nor do the "Preliminary Examination" or the trial lawyer spokesmen refute the data from the Institute for Civil Justice of the Rand Corporation that show that over a one year period, in 1984-1985, transaction costs, including plaintiffs' and defendants' attorneys fees, were "half again as large as the net compensation to plaintiffs" -- hardly a justification for the crocodile tears that trial lawyers shed so publicly for the interests of injured parties in the current liability system.

The trial lawyer supporters also distort the extent and impact of those few liability reforms that have already been implemented. One of the most egregious examples of their misleading advocacy is the statement that municipal liability insurance is still unavailable for many cities and towns and in states like Pennsylvania, where, allegedly, "the legislature virtually immunized them from liability."*

Not only did the Pennsylvania legislature not "immunize" municipalities from liability, but it permitted recoveries of $500,000 for each occurrence.

Such misrepresentation by so-called consumerists does more than raise questions about the honesty of their arguments. It also demonstrates how little they care for taxpayers' dollars. Five-hundred thousand dollars per occurrence is an enormous amount -- not some pittance to be laughed aside.

And even this limitation, as high as it is, is just a limit on severity. There is no limit at all on frequency, and insurers, even in Pennsylvania, must be prepared to continue to pay an unlimited number of municipal liability claims, on a class of business which in 1984 developed a loss ratio -- not including general expenses -- of about 260%!

That experience for municipalities has deteriorated even more than for other liability risks can be attributed in large measure to the view of trial lawyers, judges and juries that government entities and authorities refused the deepest pocket of all.

New York City projects that claims filed with it as of June 30, 1985, have a projected payout value of $1.5 billion -- and New York City is self-insured.

For insured municipalities across the nation, claims valued at between $100,000 and $250,000 quadrupled and claims valued at more than $250,000 have increased eight-fold between 1980 and 1984. During this same period, overall losses for municipal classes also quadrupled.

Recent studies by the Rand Institute for Civil Justice that analyzed jury verdicts in San Francisco and Cook County, Illinois, from 1959 to 1984 found that in cases with comparable injuries, juries assessed government or business defendants 30% to 50% more than in cases with individual defendants.

With respect to public housing authorities ("PHAs"), the Department of Housing and Urban Development ("HUD") conducted a study in 1985 to determine loss experience. Although somewhat less than systematic, the study, based on responses from 10% of the PHAs, representing some 55% of the nation's PHA dwelling units showed a loss ratio averaging 243% for the years 1982 to 1984 -- and this did not even include incurred but not reported claims.

As the HUD Assistant Secretary overseeing the study commented at a meeting in November 1985, for the federal government to insure this business would create the "deepest pocket" of all.

The losses for municipalities, including public housing authorities are real, are proven and will not disappear, even if another insuring entity enters the picture.

Someone has to pay for these and other increasing loss payments.

Even if we continue to avoid the larger question of whether we should encourage people to believe that every injury will be remedied with insurance dollars, we must recognize that there is an exorbitant price for trying to perfect a risk free society and that one of the more explicit costs is ever increasing insurance premiums and the unavailability of certain insurance coverages.

You get what you pay for, and if trial lawyers and so-called consumerists demand that negligence and fault no longer be a factor in our liability system, they have no right to complain about the cost of the insurance that funds that system.

If public officials choose to go along with this undisciplined liability explosion, they too have no cause to criticize escalating insurance costs.

More importantly, consumers will pay the price of legislative failure to reform the liability system. That is why insurers are only a part of the current effort to achieve tort reform. In increasing numbers, businesses, doctors, hospitals, directors and other purchasers of insurance are joining in the condemnation of our liability system. They recognize and have announced that the fault lies not in insurance but in the liability system which insurance funds.

Perhaps it is this alliance and the recognition that there is a broad based coalition of true consumer interests

seeking tort reform that has produced the current hysteria on the part of trial lawyers and their professional consumer allies who demagogue that advocates of tort reform are trying to "shut the court house doors" on victims of negligence.

In fact, advocates of tort reform are seeking to return the liability system to one where the word "tort" has some meaning, where only wrongdoers are punished and where the insurance mechanism is not used as a substitute for social policy imposed by a mostly unelected judiciary.

If it is national policy to create a risk free society, let both such action and the required funding be voted on and imposed by the appropriate legislatures, but do not expect insurers to continue to underprice business or to write insurance on uninsurable risks.

Insurers are profit-making organizations who have an obligation to their policyholders and stockholders to act responsibly. That insurers, in their zeal to compete for business, may have underpriced their product between 1979 and 1984, does not require continuation of such policy after its costly effect has been demonstrated.

Underwriting decisions are not made by some invisible corporate entity detached from its employees. Individual insurance company underwriters, aware of tort law developments, are making individual judgments about what risks they are willing to write and to what liabilities they are prepared to expose their companies. They know that their personal judgment and professionalism as underwriters will be on the line, as it should be in a profit-making environment.

Similarly, company management must meet the responsibility to its stockholders, policyholders and creditors of not writing coverages that will endanger the solvency of the insurer. Whether this entails significant price increases or the avoidance of certain risks, these decisions must be made despite their unpopularity with those who call for easy access to insurance at low rates, regardless of the risk underwritten.

The logic of this position, together with the proven competitiveness of the insurance industry, was why the Justice Department stated on April 22, 1986, that the Federal Trade Commission, after investigating a demand by the self proclaimed National Insurance Consumer Organization, found no evidence of collusion or cartels in the recent series of insurance company rate increases and refusals to write certain lines.

In the Justice Department's words:

> "A more plausible explanation of the current problems in the property and casualty industry is that they are a result, for the most part, of the problems in the tort liability system."

The failure of product manufacturers to take advantage of the authority granted to them in the Product Liability Risk Retention Act of 1981 (15 USCS §§3901 et. seq.) is evidence, in addition to their current support of tort reform, that non-insurance businessmen are no more willing than insurers to expose themselves to incalculable risks.

Even without pricing, policy form or other marketing restrictions, manufacturers still declined to take advantage of the Act and expose themselves to the impact of the current liability system.

The massive losses, threatening insolvency, incurred by doctor and hospital owned insurers that were set up in the mid 1970s, also demonstrate that it is not insurers who create the losses, but the nature of the risks insured, and the manner in which those risks are treated under our judicial system.

Within the last weeks, the doctors' medical malpractice mutual insurance company in Maryland, created, controlled and operated by doctors, with no commercial insurance company involvement, filed for a 50% rate increase because of severe loss experience. This is on top of an almost 30% rate increase imposed last year.

These are doctors being forced to raise their own insurance rates because of the tort liability system. They would not charge themselves more money if it were not necessary!

Doctors and hospitals are clearly aware of the real causes of the crisis and, accordingly, they too are calling for tort reform. They are not wasting their time seeking changes in insurance regulation, that will not address the underlying causes of high prices and decreasing availability.

In summarizing why insurance prices have escalated in certain liability lines and why other lines are not written by insurers, are not self-insured and are not written through captives, the Justice Department's Tort Policy Working Group observed:

> "...The changing standards of liability and causation have generated tremendous uncertainty. The 'rules of the game' of tort liability have changed so dramatically and rapidly in recent years that few are willing to speculate on what those rules will be even a few years hence. Invariably, however, those rules seem to have been changed to the prejudice of parties with pockets sufficiently deep to bear increasingly generous awards of compensation."

No wonder that the victims of the deep-pocket assaults are calling for tort reform, rather than attacking the insurance industry.

At the same time that they and others are seeking reform of the liability system, insurers, within the limitations of economic survival, are trying to ameliorate the impact of the tort crisis.

Insurers have organized market assistance plans in some 30 states. Similar plans are under discussion in other states. Under these plans, certain lines of coverage, which would otherwise be difficult to place, are being voluntarily written by insurers up to manageable limits. These plans, which do not cover totally uninsurable risks such as toxic waste exposure, range from general property/casualty lines to day care centers, municipal liability, liquor liability, rural homeowners and other commercial and general liability lines.

Market assistance plans are temporary palliatives, however. They do not address the underlying liability problem and they cannot provide coverage below cost or coverage at all for uninsurable risks.

A number of states have reacted by attempting to restrict the ability of insurers to non-renew high risk coverage but even these temporary measures have backfired as insurers are curtailing their writing of new coverage in these states lest they be locked in to them in the current judicial climate.

Similar reactions, as well as withdrawal from certain states, can be expected in response to efforts to force insurers to take on uninsurable risks or to write coverage below cost.

But fortunately, a growing number of states and the federal government are addressing themselves to resolution of the underlying crisis and are, in most cases for the first time, looking seriously at the need for comprehensive tort reform.

Commissions have been established, legislative hearings are being held, bills have been introduced, and a broad cross-section of the business and the insured community is calling for changes in the liability system that are necessary to make insurance more available.

Federal legislation has also been introduced in recent weeks to deal with the liability explosion. These bills include provisions recommended by the Administration as a result of recommendations of its Tort Policy Working Group in February 1986.

Whether some of these reforms are more appropriate for state rather than federal action is less important than that the current excesses in the liability system be corrected at some level.

As the need for such reform is increasingly being appreciated, the trial lawyers, and those afraid that fault will be restored to our negligence system, are financing a scare campaign by deceptively claiming that the reformers are trying to "shut the courthouse doors".

Insurers strongly support reforms under which the court house doors will still be open, but blameless defendants will not be held liable.

Without these reforms, the liability crisis will continue, as will the insurance problems it produces, unless the states are prepared to "insure" the crisis risks themselves, and become the ultimate, tax-funded deep-pocket.

Legislators and others would like insurers to quantify the impact of such reforms and promise specific dollar or percentage premium reductions. So would insurers. But such predictions are impossible, and to make them would be misleading.

The dollar or percentage amount of insurance savings cannot be quantified because it is impossible to predict such factors as the number of lawsuits that will not be brought, the number of cases that will never reach the jury, the dollar impact on claims examiners and attorneys of fewer and lower verdicts, the many other negative variables that will only be determined by experience, and because of the different combination of reforms proposed and the fact that they will have to be implemented by courts in 50 states as well as in the federal system.

But such lack of predictive specificity does not require ignoring common sense and the fact that savings will occur, nor does it make such legislation any less desirable.

What the insurance industry can flatly assert is that without such reform the crisis will continue. It can be patched and covered up to a limited extent, arbitrary restraints on underwriting prerogatives and pricing can be attempted, but unless real reform occurs, consumers will not have the insurance protection they seek.

If, however, the necessary reforms are implemented, insurers can also flatly assert that insurance will be available that is not being written today -- with the exception of toxic waste coverage for which federal action is required -- and that insurance premiums for other coverages will be lower than they would be if such reforms were not enacted.

It is all too easy for those studying the liability issue, in an effort to appear evenhanded, to couple calls for liability reform with proposals to restrict the ability of insurers to compete. Such tactics, however, ignore the real causes of the current crisis, and will only prevent a return to a healthy market with broad availability and less price escalation, and the type of vigorous competition that is in the public interest.

It is ironic that the same groups who have been so vociferous in their criticism of the competition that led to such bargains for insurance purchasers are now calling for removal of the industry's limited antitrust immunity through repeal of the McCarran-Ferguson Act in order, allegedly, to enhance competition.

As the Justice Department report concluded, it is "patently absurd" to offer more competition as a solution to the "allegedly excessive competition, which supposedly brought on the current crisis.

It is also ironic, and equally inconsistent, for these opponents of the insurance industry to call for federal regulation of insurance as part of their demand for tighter control over pricing and marketing, and to do so in the name of "competition".

The current crisis is caused by liability law run wild, not by defects in the insurance mechanism. To fail to enact reforms in the tort liability system, or to dilute their impact with gratuitous limitations on insurance competition, will assure continuation of the crisis.

Only real tort reform, as politically painful as it may initially seem, will truly help consumers, by creating judicial ground-rules under which the need for higher insurance prices is reduced and currently unavailable coverages can once again be written.

Senator **HECHT**. Thank you very much. I'll have a few questions. We can go right along fast. I'll be able to ask all of them.

S. 2046 seeks to limit punitive damages to only those cases where conscious disregard for the plaintiff's safety can be proved. In addition, the bill provides that awards for punitive damages be paid to the U.S. Treasury.

USES OF PUNITIVE AWARDS

There have been other suggestions for ways in which to use the proceeds of punitive awards. Could you comment on possible alternate uses, either one of you?

Reverend **McCAFFERTY**. One alternate use would be to help fund alternative dispute resolution studies and perhaps create a center or institute for alternative dispute resolution, which could make available permanent arbitrators, who would be part of such an institute or center and whose staff would be funded out of those moneys.

Senator HECHT. Thank you.

Mr. Bernstein, in your testimony, you state that plaintiffs and juries look to the deep pocket in lawsuits. Doesn't the practice of contributory negligence currently utilized in all but seven States defuse the impact of deep pocket attacks, since this seeks to equitably assign a percentage of yield to each party involved in the tort?

Mr. BERNSTEIN. No, it doesn't, Mr. Chairman. It doesn't because comparative negligence itself, was a departure from the tort system concept originally.

Mr. Justice Holmes once said: "Let the fault lie where it falls. Let the injury lie where it falls."

We've departed from that. We've moved beyond a comparative negligence system. What we've done with the deep pocket is to tack on to that the concept of strict liability, retroactive liability, with joint liability imposed on that—and we've put them altogether.

You can get a defendant who is 1-percent negligent, but who is required to pay 100 percent of the verdict. That's exactly what happened in one of the cases which New York City is defending.

That's one of the reasons that New York City feels the impact so much.

The current estimate by New York City of its liability with respect to cases already in the pipeline is $1.5 billion, and New York City is self-insured. There's no insurance company in there inflating the rates.

One point five billion dollars with respect to just its own liability.

Another interesting statistic that I think you might be interested in is that New York University in its study contemplated that the transaction costs for liability insurance over the next 4 years would total $199 billion.

The tort system has gone wild. Both defense lawyers and plaintiffs' lawyers are the ones who are benefiting from it. And it is not the injured party who is benefiting from the system.

Senator HECHT. To follow through on that, New York City, $1.5 billion in claims, what type of reserves do they have?

SELF-INSURANCE IS A MISNOMER

Mr. BERNSTEIN. They are not an insurer and are not required to have reserves. And what you have there is in effect playing with the books. Self-insurance is a misnomer. There is no insurance. It's noninsurance. And there is no requirement, no regulation of reserves.

They may estimate reserves but they don't have to set them themselves.

Senator HECHT. What are they going to do?

Mr. BERNSTEIN. You may be back into another New York City municipal crisis to bail them out, as you did in the 1970's. Maybe you'll be as successful.

But, as someone else testified today, that problem is going to multiply. It's not just the cities. Remember, last year, the Senate appropriations bill added to the performance funding formula I think a $50 million amount, which HUD was supposed to allocate to public housing authorities to buy insurance. A drop in the bucket. It wouldn't do it.

That provision died in conference anyway. But, the point is you're throwing money down the tubes. There isn't enough money in the United States to fund the type of entitlement system that the courts have imposed on us.

That's the choice we ultimately have to make in this country.

Senator HECHT. That is a very provocative statement. Thank you very much.

Reverend, your facts and figures are outstanding and it puts it right in the proper perspective when you start talking figures like that.

The staff has just said you can float another bond issue. The only difference is the last time, you were unique. This time, there's 49 other States waiting in line to float bond issues.

Mr. BERNSTEIN. Right.

Senator HECHT. And we're taking away the tax-exempt status, too, through the new tax bill.

A basic premise of tort law is that you take the plaintiff and you find him. It seems to me that the plaintiff should not be allowed to recover for an injury caused by a defendant when his insurance has already reimbursed him for medical costs involved, and where workman's compensation is paid for time off due to the injury. Should evidence of collateral sources of recovery prevent this double-dipping, Reverend?

Reverend McCAFFERTY. I would be more in favor of allowing that to be introduced into evidence at the trial for the jury to take into consideration and account, rather than prohibiting it entirely, as some have suggested.

One difficulty, it seems to me, especially with regard to insurance, at least that the plaintiff himself had the foresight to take out, is why should that plaintiff be punished for having that foresight and for having paid into a system and then not getting anything out of it, at least in the sense of not having received any damages from the defendant, who is now profitting and benefiting from the foresight of the plaintiff.

Senator HECHT. An excellent, commonsense approach.

Mr. Bernstein, beginning with the no fault auto insurance crisis of the late 1960's, we have had several insurance crises over the past couple of decades.

Are we faced with a current, actual insurance crisis?

Or is the real problem the need for better risk assessment and more narrowly crafted underwriting guidelines?

Mr. BERNSTEIN. I don't believe that the best underwriter in the world can assess the risks that are faced today by insurance companies. The risks are ever changing as the courts change the legal concepts. That is exactly what is happening. It is individual insurance underwriters, not some massive conspiracy, not large insurance companies, who knows that he's going to cost his company money and may lose his job if he makes a bad mistake, who is careful about writing this policy or not.

It's the lack not just of certainty, but the lack of reasonable expectation. That is why the crisis today is different than the prior crises. The prior crises admitted of individual solutions. No fault, which has not really been adopted on any comprehensive basis in more than one or two States and which is not really saving that much money; because of that, no fault was just a minor change in the system.

Another crisis that we dealt with in the 1970's and that was solved in 1976, supposedly, was the medical malpractice crisis.

What happened then throughout the United States, States enacted laws permitting doctors and hospitals to form their own insurers. They formed mutual insurers and set up joint underwriting associations to mandate that coverage.

$1 BILLION INSOLVENCY

Just about every one of those insurance companies is insolvent today. In fact, the hearings that are going on in New York are talking about over $1 billion insolvency for the Doctors Mutual in New York—$1 billion insolvency.

This is not part of an insurance crisis. It's part of a tort crisis. What we had before were variations on insurance crises. What we have now is a tort crisis. And it doesn't matter whether it's an insurer that got into underwriting that business, a self-insurer or a risk retention group. Until the tort problem is solved, no underwriter is going to be able to predict the risk, and there aren't enough dollars to get in to pay the type of losses that are going into that.

Senator **HECHT**. Thank you.

One last question. Many cities, corporations, and other defendants settle out of court to avoid astronomical court costs and legal fees as well as excessive media attention.

Does this kind of nuisance settlement actually increase the number of cases filed by plaintiffs looking for a settlement and add to the increase in insurance costs?

Reverend **MCCAFFERTY**. I don't think I can give a clear-cut answer to that question, Senator, unless we take into account the entire, if you will, reform of the tort liability system or consideration of its many difficulties.

That situation will never be entirely solved until we do have some clear-cut guidelines to allow for reasonable predictability for insurance carriers.

Then they can reasonably predict what risks they are exposed to, even if a case goes to litigation. Until that happens, there will be no incentive or disincentive on either side to refrain from engaging in or taking on settlement.

And, yes, indeed, that is the Damocles' sword that's hanging over the heads of many individuals and institutions who are afraid of the risk of taking the case to the jury.

Mr. **BERNSTEIN**. Mr. Chairman, you put your finger on it for that very reason. I can give you some personal experience. I happen to be the agent for the receiver of an insolvent company in Vermont, representing the Vermont Insurance Commissioner. And I see how we deal with claims.

As you know, it has been testified to, a very small percentage of cases go to trial, and a smaller percentage go to verdict.

It's not just the fact that million dollar verdicts have increased some 400 percent since 1974. It's the fact that settlements are made with a view toward the verdicts, with a view toward the tort law evolution in a given community, they reflect what the losses are expected if you go to trial.

And those settlements are made and will always be made. So what it comes down to is, until we solve the underlying problem that causes the losses that force insurers to settle, you will never be able to get a hand either on settlements or on those losses.

Senator HECHT. I want to thank both of you.

Reverend, thank you for taking a long time to come all the way here. I want to thank Gerry Wyrsch, the committee, who did the actual work, Dina Carson, George Stewart, Mary Pembroke, and Jan Maxfield, for preparing such a fine hearing. I think it's one of the best and most informative hearings we've had since I've been in the Senate.

Thank you for coming. The hearing is adjourned.

[Whereupon, at 12:40 p.m., the hearing was adjourned.]

[Response to written questions of Senators and additional material for the record follow:]

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HECHT FROM RICHARD GASKINS

AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS
of the NATIONAL ASSOCIATION OF REALTORS®

RICHARD B. GASKINS
Executive Vice President

June 24, 1986

Senator Chic Hecht, Chairman
Subcommittee on Housing and Urban Affairs
United States Senate
Washington, DC. 20510

Dear Senator Hecht:

This is in response to your letter of May 29, 1986 requesting that I respond to various questions submitted.

Q.1 For those Real Estate Appraisers who are able to get liability insurance, what percentage of the cost of your service is devoted to covering the cost of the policy?

And for those who are unable to get insurance, what percentage of the cost of your service is devoted to a fund to self-insure? That is, is it more expensive, ultimately, to have to self-insure than it is to pay the increased premiums for liability insurance?

Regarding the question you posed at the May 15, 1986 Hearing, please keep in mind there is no consistency throughout the various states in determining the premium which will be charged to real estate appraisers for professional liability insurance. Also, that a large segment of appraisers are being forced to practice without insurance. Just yesterday, I was apprised of an appraiser in Florida who had never had a claim, whose insurance was increased from $548.87 a year to $8,621.85 a year for the exact same coverage. (In this instance, we were able to obtain insurance for a premium of $2,195.00 for like coverage.) Because of this hodge-podge of establishing erratic rates and coverage there is no way to determine a percentage of the cost of appraisal services which are applied to cover the cost of insurance. Suffice it to say, it will be an increasing consideration in setting fees in the very near future.

We have not yet established a fund to capitalize a self-insurance program but we are currently meeting with a consultant to determine the viability of a captive company since traditional means of insurance has all but been eliminated for many of our members.

I hope this response is of benefit. Please feel free to call upon me or our organization if we can be of any further assistance.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRANSTON FROM

RICHARD GASKINS

Q.1 What, if any, viable options do you and your industry see as an alternative to continued liability coverage with a carrier?

Regarding Question No. 1 from Senator Cranston. The only viable options that we see as an alternative to continued liability coverage with a carrier by traditional means is the establishment of a captive insurance company. We are currently exploring the feasibility of developing a self-insurance type program because of our inability to get consistent, affordable coverage through the various insurance programs now on the market.

Q.2 Regulation of the insurance industry basically is left up to the individual states. Given problems today in the industry do you have thoughts about whether regulation should remain in states' hands?

Regarding Question No. 2. Unfortunately, we have concluded that the states do not seem capable of directing viable insurance programs in many areas, not the least of which is professional liability coverage. While clearly the bulk of administrative matters should remain within the realm of state government, consideration should be given to the federal government creating select regulations which must be adhered to by all states. An example of this would be federal legislation requiring insurance companies to make available as a matter of public record, loss history so that an industry could determine the merits of fluctuating underwriting practices and large swings in the rate premiums.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM RICHARD GASKINS

Q. Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would receive an additional award equal to 25 percent of the judgment.

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

Regarding the Question posed by Senator Dodd pertaining to the products liability bill as an amendment to S.1999, I believe the proposal is a quantum leap forward. However, I would like to see incorporated into it some type of penalty for a frivolous suit being filed.

As to the last part of the Question, I do not believe the bill to be compatible with the needs of professional liability insurance for individuals offering a service, although similar legislation is direly needed.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HECHT FROM JOHN ROUSSELOT

Q-1 In a bank's assessment of a loan customer, does the ability of that customer to get insurance play a role in the banks decision to lend to that customer? For instance, if a manufacturer would not get insurance on the product being produced would it affect the bank's decision to lend to that manufacturer? How about if a company could not get directors and officers insurance?

In a large loan, particularly if its unsecured, to a manufacturing company, all factors bearing on creditworthiness are taken into consideration. If a particular product manufacturer cannot get product liability insurance, the manufacturer possibly could be put out of business by a large judgment against the company for which there is no insurance. The absence of D&O insurance probably has a greater bearing on the company's ability to attract qualified officers and directors than on a bank's decision as to whether to lend to the company.

Q-2 What kind of expected savings do you anticipate for savings institutions should captives for directors and officers insurance be sanctioned?

Ans. Because some institutions can not obtain insurance at all, facilitation of the formation of captives will likely provide insurance where none was formerly available. If more captives are formed which provide competition to the conventional market, over time the price of insurance should go down, availability should increase, and hopefully policy coverage should improve.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRANSTON FROM JOHN ROUSSELOT

Q-1 What, if any, viable options do you and your industry see as an alternative to continued liability coverage with a carrier?

Ans. There are options to continued liability coverage with a carrier; however they are less desirable to various degrees than conventional coverage.

For example, some institutions have no directors and officers (D&O) liability coverage at the moment. Many of these institutions provide indemnification for their directors and officers, pursuant to charter or by-law provisions. However, it is not clear whether the institution would be permitted to honor the indemnification particularly in the case of a suit by one of the Federal insurance agencies. In addition, if the institution is in serious difficulty and approaching insolvency, there may not be funds to cover the indemnification.

Some institutions have established pools with other institutions to insure themselves. There are many legal difficulties making it less than satisfactory. An insurance company organized by National Council members in 1972 is in the process of reorganizing from a reinsurance company to a direct writer of D&O insurance as a result of the crisis. This approach provides coverage by a carrier.

Q-2 Regulation of the insurance industry basically is left up to the individual states. Given problems today in the industry, do you have thoughts about whether regulation should remain in states' hands?

Ans. While we generally believe in the wisdom of states' regulation and do not believe that the Federal government should lightly override the states, we did testify in support of extending the Risk Retention Act which contains a limited Federal override.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM JOHN ROUSSELOT

Q-1 Senator Danforth and I have recently introduced a products liabiliity bill, as an amendment to S. 1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may procceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would receive an additional award equal to 25 percent of the judgment.

Ans. While we appreciate being asked your question, the National Council really is not competent to answer it. We have testified on directors and officers liability insurance which, while a type of liability insurance, is very different from product liability insurance. If a shareholder sues the officers and directors for breach of duty in connection with a takeover contest, the issues would involve application of the business judgment rule, not the amount of pain and suffering of the plaintiff. Thus, we do not have an answer to your very sophisticated question.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HECHT FROM
DAVID A. DAILEDA

Q.1 You observed that many of the programs overseen by this Subcommittee such as the rehabilitation of multi-family public housing and the rejuvenation of neighborhoods involve the work of architects. What implications do you se for the Federal funding levels of these programs should architects face perpetually rising insurance costs?

Q.2 What percentage of the cost of your service goes to cover liability insurance?

Q.3 To what extent does asbestos abatement affect the liability insurance costs for architects?

A.1-3 As liability insurance costs increase, professionals must naturally pass the higher costs on to their clients. Architects involved in the rehabilitation of multi-family public housing and the rejuvenation of neighborhoods must likewise pass increased insurance costs on to the federal government programs that fund these projects. In today's market, 4 percent to 15 percent of an architect's gross billings are used to purchase liability insurance, when it is available, and that does not include payments below the deductible level. Furthermore, for some types of work, notably asbestos abatement projects, adequate insurance coverage is simply not available.

Q.4 The insurance industry would offer claims-made insurance as a cure-all for the present liability insurance problem. Architects have operated under claims-made insurance for years. Has it solved your problems with either availability or affordability?

A.4 These difficulties with availability and affordability have arisen despite the claims-made form of insurance coverage that architects have operated with for years. Our experience does not support assurances by some members of the insurance community that claims-made insurance policies will cure the nations liability woes. When insurance becomes entirely unattainable, the client, in this case the federal government, must work with a narrowed field of potential competitors (those contractors willing to work without adequate liability insurance), and accept, officially or unofficially, some portion of the liability.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRANSTON FROM
DAVID A. DAILEDA

Q.1 What, if any, viable options do you and your industry see as an alternative to continued liability coverage with a carrier?

A.1 Several months ago the AIA commissioned a study of the possibility of setting up an association-based insurance program that would be open to all AIA members. Our hope was to be able to offer a liability insurance option to architects. Those of us searching for a viable alternative to the exorbitant costs of insurance with the few private carriers still covering design professionals were disappointed by the results of the study. Initial capitalization costs (estimated at $10 million) are beyond the means of the Institute and its members. Even were the administrative and set-up costs to be greatly reduced through passage of risk retention legislation, the $10 million requirement effectively eliminates such a program as an alternative for architects.

Q.2 Regulation of the insurance industry basically is left up to the individual states. Given problems today in the industry do you have thoughts about whether regulation should remain in states' hands?

A.2 Whether regulation of the insurance industry should be left up to the individual states is a difficult question. The individual and particular needs of an area might be better served by direct state regulation, but whether this general statement is true of the insurance industry I do not know. The federal government might be better able to answer such a question were more information concerning the industry available to it. Towards this end the AIA has written in support of the Insurance Information Act of 1986 that Senator Simon and Senator Rockefeller have introduced. I have enclosed letters signed by the president of the Institute endorsing this legislation.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM
DAVID A. DAILEDA

Q. Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would receive an additional award equal to 25 percent of the judgment.

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

A. Most product liability reforms, in fact most tort reforms under discussion at the federal level, involve personal injury suits. The bulk of claims against architects involve property damage, while only twenty percent relate to death or injury. Half of these are construction site injuries, and yet in many states, architects are not protected under the workers' compensation umbrella. Reform of workers' compensation laws is therefore the most direct and appropriate solution to the majority of personal liability claims faced by members of the Institute. Were the project architects included under the workers' compensation laws, both the issues involving a cap on pain and suffering and the collateral source rule would be resolved for construction site cases. A worker's claim for compensation would be simplified in terms of number of defendants, court time and legal fees.

We support your struggle to eliminate joint liability. This is, for the most part, an outmoded encumbrance to the judicial and compensatory processes. Congressman Florio has introduced a bill concerning asbestos abatement in the House (H.R. 5073) that actually contains language to remove abatement contractors from the threat of joint liability in the language of the bill. This may be the most direct approach available to the federal government for any other than product liability. Senator Stafford's version of that bill (S. 2083), which has passed through subcommittee and is pending action by the full committee, does not yet contain this language.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HECHT FROM LEONARD MILLER

Q.1: What percentage of the cost of a house is tied up in liability insurance all down the line? That is, what impact does liability insurance have from the architect to the builder to the final sale?

A.1: This a very difficult question to answer. I did hear recently about a builder in Southern California who entered a joint venture to build 100 homes in a subdivision. The general liability insurance premium for the project was $200,000, or $2,000 per home. In order to determine the effect on every home, or an average home, it would require an enormous amount of research. Further, it would be very difficult to quantify the insurance costs attributable to every aspect of homebuilding, from logger to architect to supplier to subcontractor to builder to buyer.

Q.2: How does participation in the Home Owner's Warranty program affect your insurance rates?

A.2: A member of our Liabilty Task force recently stated that he was given a 5% premium credit on his liabilty insurance because he was a HOW buider. This is the only instance I have heard of such a credit. In discussions with representatives of two companies who underwrite programs specifically for builders, neither gave such credits, nor had they ever considered giving such credits.

Q.3: You mentioned reinsurance in your testimony as another aspect of the insurance industry that has been adversely affected by ballooning damage awards. How important is the reinsurance market to the housing industry?

A.3: Currently, seven of NAHBs affiliated state associations sponsor self-insured workers' compensation programs for their members, and another five state associations are considering establishing these programs. The success of these programs are largely dependant upon reinsurance to protect the funds from large single losses or total losses within a fund year. Due to the reduction in capacity of the reinsurance industry, caused by the liabilty crisis, this type of reinsurance has been increasingly difficult to find on a favorable basis. In addition, it is suspected that those of our members who have a need for large amounts of liability insurance, such as large developers or home builders, commercial builders and multi-family builders, are receiving substantial increases in premiums--largely attributable to increases in reinsurance costs.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRANSTON FROM LEONARD MILLER

Q.1: What, if any, viable options do you and your industry see as an alternative to continued liability coverage with a carrier?

A.1: The proposed expansion of the Risk Retention Act to allow groups to self-insure liability insurance would open the door for discussion of a viable alternative to traditional markets for insurance for our members. However, there is a concern that:

- amendments to the act would be prohibitive to the economical functioning of such a captive.
- the "crisis" will be over before: (1) the Risk Retention Act is expanded; and, (2) a viable captive could be formed.

There is, of course, concern that the problems with the civil justice system which have plagued the insurance industry would also cause problems for a captive insurer.

Q.2: Regulation of the insurance industry basically is left up to the individual states. Given problems today in the industry, do you have thoughts about whether regulation should remain in states' hands?

A.2: One of the problems our Task Force has encountered is the unavailability of information from the insurance industry. We, as other industries, would like more information on claims, profits and losses of the insurance industry, which will provide more accountability to the insurance consumer. To date, state regulation of the insurance industry has not encouraged the exchange of information. But, I'm not sure that federal oversight or intervention would change this.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM LEONARD MILLER

Q. Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liabilty area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay a net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would recieve an additional reward equal to 25 percent of the judgement.

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

A. The basic approach as outlined in Senator Dodd's question attempts to create incentives to settle disputes. Alternative dispute resolution (ADR) is a worthy goal that we fully support. However, there are more straight-forward ways of encouraging ADR than the approach as outlined above.

Our main objection to that approach lies in choice number two. Abolition of the collateral source doctrine, with appropriate limitations in the definition of collateral sources, should apply to all cases to prevent double recoveries by plaintiffs. Likewise, joint and several liability should be abolished in all cases except where the co-defendents acted in concert. The abolition of these two legal developments, as applied to both economic and non-economic damages, should not rest on the prerequisite that a manufacturer must make an offer of settlement that is then refused by a claimant. A manufacturer should not be forced into making a settlement offer for a frivolous claim or a claim for which the manufacturer has minimal responsibility in order to get the benefit of reasonable reforms to our civil justice system.

Questions for all Witnesses from Senator Dodd - Page Two

Moreover, non-economic damages should have some basis in objectivity. Reasonable caps or other limitations on non-economic awards are important, but become less significant if liability standards are changed back to a fault-based system.

In Title II of Senator Danforth's revised bill (S. 1999), sections 201 and 202 present a more workable and appropriate incentive to settle disputes. That is, if a party refuses a settlement offer and that party eventually loses in court, then he will be liable for attorney fees and costs of the other party who made the settlement offer. Of course, a party's refusal of a settlement offer would be based on the belief that they have a meritorious claim or defense and that they can obtain a better result at trial. Therefore, the attorney fees and costs incentive will work only if a fault-based system is restored. Otherwise, defendants will seldom have a "meritorious" defense. But plaintiffs will still be able to recover, as they should, for injuries caused by the fault of the defendant.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HECHT FROM DENNIS J. FITZGERALD

Q.1 What percentage of the cost of an average fare in public transportation is devoted to covering the cost of liability insurance?

A. It can be estimated from available figures that liability and casualty expenses are presently consuming almost 10 percent of total operating expenses. It should be kept in mind that fares cover only approximately one-third of total operating expenses.

Q.2 Should the increases of the past few years continue, what will the percentage of the cost of a fare be in five years?

A. It is difficult to determine a percentage of fares which would reflect liability and casualty expenses in five years. The factors driving the liability crisis - the nature of the insurance industry itself and the operation of the civil justice system - are likely to change in the next several years.

Nevertheless, assuming the present approximately 400 percent-a-year rate of increase in insurance costs - or 2000 percent for a five year period - it is safe to say that insurance costs would represent a significantly greater portion of fares than is presently the case. The exact percentage would depend upon the relative increase of other expenses, such as fuel, labor and spare parts. We do not envision a 2000 percent increase in these terms. Therefore, the bite that insurance costs take out of fares, as well as out of public support and other income, is likely to be a significantly greater percentage than is the case today, but immeasurable at this time.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRANSTON FROM
DENNIS J. FITZGERALD

Q.1 What is the scenario down the road and in what time frame unless rate increases abate?

A. Currently, the public transit industry is held hostage to a dwindling insurance market and soaring costs. We are the victim of an insurance crisis which seems to have no easy solution. The cost impact on public transit, already burdened with extremely tight fiscal conditions and continually threatened by additional cuts in the federal transit programs, is very serious.

If conditions do not change and we continue at the current 400 percent rate of increase in insurance costs, we will have to look to increasing our fares, which in the long-run will reduce ridership, or seek an increase in government assistance or face complete loss of service.

Q.2 Could you tell me about the feasibility of pooling arrangements for public housing authorities or transportation authorities?

A. Wisconsin is currently the only state which has created an insurance pool for transit systems. Oklahoma, Arkansas, Tennessee, Pennsylvania, Minnesota and North Carolina are also considering similar arrangements for their states.

The many factors in such arrangements including homogeneity and size of the pool, strength of management and experience make prediction of their success difficult to determine. Further, even if all of those characteristics are in place, outside influences such as the cycled nature of insurance industry could influence their efficacy.

Based on the short term results, it appears that at least in some states these pooling arrangements are feasible.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM DENNIS J. FITZGERALD

Q.1 Senator Danforth and I have recently introduced a products liability bill, as an amendment to S. 1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would receive an additional award equal to 25 percent of the judgment.

Please give me your comments on this approach and whether you thing a similar approach may prove workable and desirable in this area as well.

A. The need to provide for alternative dispute resolution, to limit non-economic damages, to restrict joint and several liability and to expedite activities under our civil justice system is being widely recognized. Senators Dodd and Danforth are to be commended on their forward-looking approach to the products liability crisis. Extension of the concepts advanced by S. 1999 to other areas would have to be coordinated with the other tort law reform efforts already under way in at least five other proposals.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SASSER FROM

DENNIS J. FITZGERALD

Q.1 I am interested in your comment about the transit association captive insurance company in Wisconsin. I understand that the Tennessee transit authorities have been discussing the use of a state-wide insurance pool. Is this the same type of approach as this insurance program in Wisconsin?

A. Wisconsin presently has in operation a captive insurance company serving 15 cities and towns and providing $3 million of liability coverage, with reinsurance covering liabilities above $1 million and below $3 million.

In Tennessee, a consultant is being retained to study the insurance needs of up to eight urban and 17 other rural transit systems. Presently Memphis and Nashville are without insurance coverage. The study will examine insurance pooling and the creation of a captive insurance company as proposed solutions to the problem. An insurance pool would include the possibility of having to assess additional costs against its members to reflect actual risk experience. Unlike the Wisconsin example, Tennessee would include in its proposal both the largest and the smaller systems in the same risk pool.

Q.2 Can you tell me whether you think this is an effective approach to insuring transit systems?

A. The question of whether captive insurance companies or insurance pools are effective depends upon a number of factors, including the size of the risk pool, the homogeneity of the risk pool, the strength of the organization managing the insurance affairs of the group and actual risk experience. Although the Wisconsin company has been in operation for less than half a year, costs are anticipated to be only 30 percent of the price for equivalent insurance coverage on the open market.

Q.3 If so, is there anything that we in Congress can do to encourage the use of this type of program?

A. Federal efforts aimed at removing barriers to the formation of captive insurance companies are, of course, helpful to their creation. The Product Liability Risk Retention Amendment (S. 2129), introduced by Senator Kasten, would extend the 1981 law from the products liability area to all casualty insurance. Consideration should be given to the effect this and similar bills would have upon the utilization of captive insurance companies as a solution to the present insurance crisis.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HECHT FROM MARYANN M. RUSS

Q.1 How will the increased cost of liability insurance affect Federal funding levels for housing should the increases of the past few years continue?

A.1. If HUD continues on its present course of considering increased insurance costs to be a problem of PHAs but not of HUD, there will be no short-term effect of the insurance cost increases on federal funding levels. The mid-term effect will be devastating, of course. Uninsured housing authorities will sustain losses they cannot pay and housing authorities that are able to find insurance will be paying a higher and higher proportion of operating funds for insurance. Over the long run the federal government will be faced with the unappealing choices of either bailing out PHAs or taking them over.

Q.2 What percentage of the operating budget of your PHA is currently devoted to liability coverage? Should the rates increase at the present pace, what percntage do you expect to be paying in the future?

A.2. In our FY 87 operating budget (our current fiscal year) insurance amounts to 5.2 percent of operating expenditures (up from just over one percent last fiscal year). One third of our insurance cost is for liability insurance.

If rates increase at the present pace, we could be paying seven to eight percent of our operating expenditures for insurance in the coming fiscal year. Should this occur, we will be forced to cut or scale back other services since there is no other way to absorb such a cost increase.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CRANSTON FROM MARYANN M. RUSS

Q.1 What is the scenario down the road and in what time frame unless rate increases abate?

A.1. Unless rate increases abate or HUD augments our operating subsidy to cover rate increases, the majority of medium and large PHAs will either be uninsured or facing financially troubled status within the next two years.

Q.2 Could you tell me about the feasibility of pooling arrangements for public housing authorities or transportation authorities?

A.2. The Council of Large Public Housing Authorities has formed an Insurance Crisis Study Group to investigate the feasibility of pooling arrangements for public housing authorities. Preliminary indications are that one major bar to pooling is the lack of specific authority for interstate pooling by PHAs. We are hopeful that S.2129 or some other legislation will provide the permission we need to form a nationwide pool.

At this time we are by no means assuming that pooling will solve all our problems. We simply want to be sure that it exists as an option.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM MARYANN M. RUSS

Q. Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would receive an additional award equal to 25 percent of the judgment.

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

A.1. **If the approach you are proposing in the area of product liability was expanded to encompass general liability it could be of benefit to PHAs. First, individuals with legitimate claims could receive relief more quickly. Second, the expense to handle nuisance claims could be reduced.**

We favor alternatives to litigation as being more timely and less expensive.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM LEE RUCK

Q. Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers the claimant also would receive an additional award equal to 25 percent of the judgment.

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

A. **The National Association of Counties, through its Task Force on County Liability and Insurability, has specifically determined not to take a position in regard to federal legislation in the area of products liability. Therefore, I am unable to specifically respond to Senator Dodd's questions.**

However, NACo does generally support the concepts of alternate dispute resolution. To the degree that Senator Dodd's amendment creates a less expensive method of resolving products liability disputes, by reducing the transaction cost of litigation, it seems to propose a worthwhile concept. The Association recommends serious consideration of this -- and any other -- legitmate alternative to the social price tag of resolving all disputes in the court room.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM STEPHEN CHAPPEL

Q. Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would receive an additional award equal to 25 percent of the judgment.

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

A. Enclosed please find an additional two copies of the U.S. Conference of Mayors survey of 145 cities on the liability crisis. Additional copies are, of course, available at your request.

Your staff has also requested our comments on the various product liability limitation bills circulating in your committee, notably, the bill proposed by, among others, Senator Dodd. As cities are neither producers nor distributors of products, per se, the U.S. Conference of Mayors has no policy on this subject. As purchasers and users of these products, cities stand in the same shoes as most consumers; thus, we feel that some protections are needed.

However, the products liability models that are circulating offer some surprising and thoughtful proposals for alternative dispute mechanisms, from administrative hearings to inducements to aggressive parties to settle their disputes prior to full-fledged litigation. As indicated in my testimony of May 15th, to the extent that such alternative mechanisms provide a forum for the meaningful resolution of disputes, and also serve to promote the reduction of transaction costs, the Conference of Mayors could support them.

I am hopeful that this explanation of our stance meets your need for information.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM
DAVID M. FARMER

Q.1 Let me first address the availability problem. Some people have argued that the present insurance crisis was made by the insurance industry and have argued for repeal of the McCarren-Ferguson Act as the solution. Under present law, can insurers engage in boycotts of insureds?

A.1. Insurers are subject to the application of federal antitrust laws for acts of boycott, coercion and intimidation.

All boycotts or agreements to boycott are subject to both criminal and civil penalties applicable to antitrust violations.

The courts have tended to broadly construe the boycott exception and narrowly construe the business of insurance exception that the industry has under McCarran Ferguson.

A prime illustration of this principal is the Supreme Court's decision in St Paul Fire and Marine Insurance Company vs. Barry (438 U.S. 531, 1978).

The court decided that for both McCarran and Sherman Act purposes a concerted refusal to deal with customers by insurers would be a violation. Insurers may not jointly refuse to provide insurance to any group of policyholders. It should be pointed out that any individual insurers acting unilaterally may refuse to sell one type of insurance in a particular state. Insurers are doubly bound by state laws which prohibit unfair discrimination or other unfair trade practices. The application of the antitrust laws, the McCarran Act as interpreted by the courts, and state laws prevent the joint refusal to deal by insurers acting in concert.

Q.2 In order to evaluate the likely effect of repeal of McCarren-Ferguson, it is important to know the level of competition in the industry today. Could you give us some figures as to the number of companies and their market shares in some of the different types of insurance we are discussing today? Would those concentration levels be high or low on a traditional index of concentration, such as the Herfindahl-Hirshman index?

A.2. The insurance industry consists of over 3000 property and casualty companies with about 900 companies writing most of the business. No single company has significant market concentration in the areas that have been affected by the current situation of availability/affordability. A recent analysis of the impact of McCarran on the current situation is contained in the February 1986 report of the Tort Policy Working group. This interagency study by the Justice Department and some ten federal agencies made the following observation: "It is hard to reconcile the argument that the current problems of the insurance industry stem from 'excessive competition' with the preferred solution of removing the industry's antitrust immunity. Since the goal of the antitrust law is to enhance competition, if one truly believes that the problems of the insurance industry are a result of too much competition, the last thing one would advocate is a legal change that would increase the level of competition (page 27) (footnote 16 on page 27). Despite the assertions of some, the working group found no evidence to suggest the industry's antitrust immunity is a significant factor in the insurance availability/affordability crisis."

The Antitrust Division of the Department of Justice has been critical of the immunity provision in the past, but did not believe that it had relevance to the current situation.

In regard to concentration ratios, we would refer to a statement by Dr. Willard F. Mueller (appearing in an Arthur D. Little study, Prices and Profits in the Property and Liability Insurance Industry). Dr. Mueller, former director of the Bureau of Economics of the Federal Trade Commission, stated:

> "Empirical evidence indicates that the discretionary pricing power becomes quite severely limited when the top four firms in an industry control less than half, and the top eight firms control less than 70% of the industry's output."

At the present time, the largest company in the property and casualty industry is State Farm, with a market share of 9.2 for all lines. The top ten companies have only a 39.1% market share. There is a slightly higher concentration ratios for miscellaneous liability (9.7 for the leading writer, American International Group). By any accepted analysis, the industry is structured for competition and has demonstrated its competitiveness over the course of a number of years.

Q.3 Of course, affordability is another problem. It has been suggested that the industry is raising prices in order to make up for poor underwriting practices over the last few years. Could you comment on that view? What assumptions are you making in setting rates with respect to the laws that you will be paying out under?

A.3. It is our view that affordability and assumptions that companies are using will vary by line, by state and a number of other variables. It can generally be said that insurance will be more available and affordable in states where a reasonable amount of certainty exists within the legal system.. As companies begin to recover from the financial difficulties of the past years, stability will return to the marketplace. Not all lines of liability insurance will become readily available, however

because of real problems within the legal system. In the areas of pollution liability and medical malpractice, for example, it is clear that significant tort reform will be required to encourage new entrants into those markets. The suggestion that insurers are raising prices for yesterday's losses is wrong. Insurers are carrying prices today for future losses. Underwriting losses on old policies are not recoverable costs and may not be recouped with today's prices. Underwriters make judgements about the future based on the past, but not on recovering past losses.

Q.4 Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers the claimant also would receive an additional award equal to 25 percent of the judgment.

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

A.4. In regard to federal product liability proposals, we believe that workable solution needs to incorporate most of the following provisions in order to accomplish the objective of a balanced predictable system:

1. A return to a fault based system;
2. Removal of disincentatives to product improvement;
3. Limiting the length of the product liability tail;

4. Restricting design liabilities to those that are unreasonably dangerous; and

5. A proper allocation of liability between manufacturer and modifiers of products.

It would also be desirable to cap pain and suffering awards and encourage some alternative dispute resolution mechanism. Any reforms, in our view must address all of the above concerns not a cap on non-economic losses alone. The proposed penalty of 25% of the judgement may be a disincentive to arbitrating disputes among parties. Proposed caps such as contained in the Commerce Committee's products liability proposal may be helpful, but only if other areas of concern are addressed as well. The proposal standing alone will not significantly address the problems that currently exist in the area of products liability.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM
ROBERT L. ZEMAN

Q.1 Let me first address the availability problem. Some people have argued that the present insurance crisis was made by the insurance industry and have argued for repeal of the McCarren-Ferguson Act as the solution. Under present law, can insurers engage in boycotts of insureds?

A. 1. You have posed the question as to whether under the McCarran-Ferguson Act insurers may engage in a boycott of policyholders. Insurers are unequivocally prohibited by the terms of the McCarran Act from engaging in any act of boycott. That law begins with a general exemption from federal antitrust laws for the insurance industry to the extent that business is regulated by the states. The McCarran Act goes on, however, to specifically prohibit boycotts by insurance companies: "Nothing contained in this Act (McCarran-Ferguson) shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation." (15 U.S.C. §1013(b)) (emphasis added).

The McCarran Act's restrictions on insurance company boycotts have been strictly enforced, with increasing vigor, by the courts. For example, in St. Paul Fire and Marine Insurance Company v. Barry, 438 U.S. 531 (1978), four insurance companies writing medical malpractice insurance in the state of Rhode Island agreed that three of them would not deal with the disgruntled policyholders of the fourth as a means of assuring their submission to a new type of policy. The U.S. Supreme Court held this group conduct clearly fell within McCarran's boycott prohibition, thus making it clear that the McCarran Act prohibits insurance company boycott of policyholders as well as inducements to boycott competitors. In Barry, the court wrote, "The illegality consists, not in the separate action of each, but in the conspiracy and combination of all, to prevent any of them from dealing with the target."

In recent months a few insurance industry critics have charged that current availability problems have resulted from a conspiracy on the part of insurance carriers to engage in a boycott of specific types of risks, and that such action is made possible by the industry's antitrust exemption. The latter charge is clearly erroneous, for as indicated by the above analysis, statutory and case law specifically prohibit insurance company boycotts. More importantly, the Justice Department and the Federal Trade Commission have concluded the former substantive charge of boycott is baseless and totally without merit. In rejecting the National Insurance Consumer Organization's request for a Department of Justice investigation of a purported industry boycott, DOJ cited an FTC study of the insurance industry which "has now closed because (the FTC) was unable to find any evidence of collusion." The department concluded, "A more plausible explanation of the current problems in the property/casualty insurance industry is that they are a result, for the most part, of problems with the tort liability system." Based on its initial investigation the Department of Justice has declined to further proceed with an investigation of the alleged insurance company boycotts.

Q.2 In order to evaluate the likely effect of repeal of McCarren-Ferguson, it is important to know the level of competition in the industry today. Could you give us some figures as to the number of companies and their market shares in some of the different types of insurance we are discussing today? Would those concentration levels be high or low on a traditional index of concentration, such as the Herfindahl-Hirshman index?

A. 2. You have inquired as to the level of competition in the insurance industry today. The attached exhibit contains top-of-the-market sales concentration ratios and Herfindahl-Hirshman indexes for general liability insurance in individual states and countrywide. These market power measurements are based on direct premiums written in 1984. The data are supplied by A.M. Best Company.

In its guidelines for analyzing the economic impact of proposed mergers, the United States Department of Justice has recommended that market power be measured using the Herfindahl index. Markets with index values less than 1,000 are considered to be "unconcentrated"; markets with index values between 1,000 and 1,800 are considered to be "moderately concentrated"; and, markets with index values greater than 1,800 are considered "highly concentrated". These critical values are based on well defined products sold in national markets.

The exhibit shows that the countrywide market for general liability insurance is structurally oriented toward competition. It is extremely unlikely that noncompetitive conditions can be sustained in markets that are competitively structured. In the absence of government imposed restraints on trade, any firms attempting to exercise market control unilaterally suffer a declining market share and attempts at collusive interference with market forces are impractical due to the large number of actual and potential competitors.

Even when the market power indexes are viewed at the state level, general liability insurance is unconcentrated. The one exception occurs in the state of Michigan where Motors Insurance Group's business with its manufacturing affiliates (General Motors) distorts the picture. When Motors Insurance Group is excluded from the Michigan calculation, the Herfindahl index falls to 331, indicating an unconcentrated market.

[Technical note: The HHI was calculated from direct premiums written by the top 50 insurers in each state. The market share not written by the top 50 groups was evenly distributed over remaining insurers using the assumption that those insurers each wrote a share equal to that of the 50th largest writer. This causes the HHI to be overstated by a very small amount. Detailed exhibits for each state and D.C. are available, if needed.]

Q.3 Of course, affordability is another problem. It has been suggested that the industry is raising prices in order to make up for poor underwriting practices over the last few years. Could you comment on that view? What assumptions are you making in setting rates with respect to the laws that you will be paying out under?

A. 3. You have asked us to comment on the suggestion that the insurance industry is raising prices in order to make up for poor underwriting practices over the last few years. We believe this characterization of the problem oversimplifies and distorts the major causes of insurance affordability dilemmas.

It is true that during the late 1970s and early 1980s commercial lines insurers severely underpriced their policies, relative to the risks they assumed through them, in order to take advantage of higher interest rates that were available during that time. The industry experienced a surge of competition, and despite expanding liabilities and escalating losses insurers reduced prices so as to obtain more premium dollars.

Gradually, however, losses incurred by insurers on the policies they wrote due to problems within the civil justice system outstretched investment income, resulting in record losses for the industry in 1984 and 1985.

It is thus clear that underpricing of policies by the industry contributed to current insurance affordability problems. However, in addition to depressed premiums, a major contributing factor to affordability problems entails the significant increase in losses experienced by the industry in recent years. Over the last five years, growth in insurance company losses has significantly outpaced economic growth as measured by the gross national product. During the period 1979 to 1984, the GNP grew 50 percent, while losses paid by commercial liability insurers increased 130 percent.

Due to escalating losses caused by inequities within our civil justice system, combined with previous underpricing of policies, insurers have experienced returns on net worth far below the average return for the Fortune 500 companies every year since 1979. Accordingly, insurers have had to raise prices, not to recoup lost profits or make up for "poor underwriting practices", but to bring current premiums in line with current losses.

On a related note, you have inquired as to the assumptions insurers make in setting rates with respect to the laws they will be paying out under. This inquiry is imminently relevant to the availability issue, for radical changes in liability laws under which insurers compensate claimants have contributed substantially to insurance unavailability.

Assumption of risk is the essence of the business of insurance. Nevertheless, insurance underwriters do need concrete legal standards upon which they determine appropriate rates. When underwriting policies, insurance companies must calculate rates based on the law as it exists at that time; that is, underwriters have no choice but to presume the law will be the same when the time comes for payment of a claim under that policy.

Unfortunately, this presumption has proven false in recent years. Through a number of liberalizing court decisions, the judiciary has increased liabilities of insurance companies. On the one hand the courts have expanded substantive tort liability by creating new rules of liability and allowing increasing damages awards. Other decisions have liberally interpreted insurance policy language so as to provide coverage according to the "reasonable expectations" of the insured rather than according to the literal terms of the contract as originally executed by the insurance company and its policyholder. Collectively these decisions have destroyed the essential standards on which insurers may properly calculate rates of coverage.

Q.4. Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would receive an additional award equal to 25 percent of the judgment.

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

A. 4. Finally, you have asked for comments on the approach taken by Senator Danforth's amendment to S-1999, the Product Liability Voluntary Claims and Uniform Standard Act. That bill would largely preempt state product liability law and substitute a comprehensive federal law governing substantive and procedural aspects of product liability claims.

It should be noted that NAII has taken a neutral position with respect to previous federal product liability reforms including the original version of S-1999. We neither supported nor directly opposed the proposal primarily because we felt, in light of its complexity and attempted preemption of state liability standards, the bill would not have achieved the desired uniformity, enhanced certainty and insurability. Unfortunately, nothing in the most recent amendments to S-1999 would warrant alteration of that stance.

S-1999 was purportedly amended so as to simplify the measure. We question, however, whether this newer version achieves that goal. For example, we doubt that the tort liability damages reforms are substantial enough so as to really impact on the problems of expanding product liability awards and decreasing insurability. Under the expedited settlement process, the only significant reform would consist of a cap of $250,000 on noneconomic awards. If the plaintiff avoids the expedited process and elects to proceed through standard litigation, virtually no limits on damages, except for punitive awards, would apply. Only if the plaintiff institutes litigation and rejects a settlement offer by the defendant would the major reforms apply such as several liability only for noneconomic damages and a noneconomic cap of $250,000.

We also question the wisdom of including within the expedited claims system a procedure that incorporates the market share theory, under which a consumer can make a claim against any manufacturer of the type of product that injured him. Finally, it appears the 25 percent penalty imposed upon a defendant for failing to pay an expedited claim that is ultimately litigated in plaintiff's favor is excessive. S-1999 includes no similar provision penalizing plaintiffs for making specious claims.

In sum, the incomplete tort reforms contained in S-1999 and the complexity and uncertainty surrounding its expedited claims settlement process would preclude direct support by NAII for the measure. We believe the simpler S-100, the original administration proposal now sponsored by Senator Kasten, and its more comprehensive tort reforms and maintenance of existing state substantive and procedural product liability law would be more effective at returning insurability to the product liability market.

NAII sincerely appreciates the opportunity to present testimony before your Subcommittee and through these follow-up questions. If you would like additional information relating to any of these issues, feel free to call on us at any time.

Very truly yours,

Robert Zeman
Robert L. Zeman
Assistant Counsel

RLZ:mp
Attachment

MARKET CONCENTRATION FOR GENERAL LIABILITY INSURANCE

6
DODD--ZEMAN

STATE	CUMULATIVE MARKETSHARE				HERFINDAHL	
	TOP 4	TOP 8	TOP 20	TOP 50	INDEX	NUM. EQV.
ALABAMA	24.15	41.62	65.96	89.53	299	33.46
ALASKA	41.52	56.70	82.45	97.20	572	17.47
ARIZONA	42.28	53.60	73.12	92.50	680	14.71
ARKANSAS	27.54	44.82	71.90	91.16	362	27.61
CALIFORNIA	26.27	42.33	66.99	88.96	316	31.61
COLORADO	29.70	42.34	66.05	89.97	361	27.74
CONNECTICUT	40.77	62.73	83.19	96.56	612	16.34
DELAWARE	32.32	51.08	76.46	95.12	437	22.88
DC	30.70	53.54	86.31	97.53	503	19.88
FLORIDA	25.68	41.33	64.65	86.34	297	33.63
GEORGIA	24.43	38.82	63.11	87.14	291	34.36
HAWAII	34.19	55.23	84.54	99.59	512	19.53
IDAHO	22.37	38.75	70.73	95.49	310	32.25
ILLINOIS	24.27	39.88	65.12	88.21	288	34.71
INDIANA	20.16	35.12	66.13	87.67	258	38.79
IOWA	23.56	40.21	67.52	90.47	300	33.33
KANSAS	29.80	46.19	68.64	90.64	360	27.79
KENTUCKY	31.16	45.17	69.66	89.76	413	24.23
LOUSIANA	30.30	46.66	71.16	90.75	377	26.51
MAINE	27.18	45.91	77.69	95.63	389	25.68
MARYLAND	25.03	43.44	72.58	93.40	338	29.55
MASS.	31.00	50.52	76.87	95.33	439	22.76
MICHIGAN	56.80	67.74	82.79	94.05	2,181	4.58
MINNESOTA	22.50	39.05	64.19	87.30	276	36.18
MISSISSIPPI	37.57	54.40	76.00	92.71	574	17.42
MISSOURI	24.15	37.48	63.16	89.38	284	35.19
MONTANA	28.92	46.87	73.81	93.42	400	24.99
NEBRASKA	23.25	37.23	61.94	90.56	278	36.00
NEVADA	32.89	53.01	77.40	96.13	446	22.42
NEW HAMPSHIRE	33.76	50.78	75.43	94.95	459	21.78
NEW JERSEY	27.12	43.03	68.20	89.96	341	29.31
NEW MEXICO	22.23	37.05	66.83	92.51	287	34.80
NEW YORK	33.73	49.49	76.17	93.52	459	21.80
NORTH CAROLINA	31.81	46.61	71.13	91.71	394	25.40
NORTH DAKOTA	27.38	42.17	67.85	90.24	339	29.47
OHIO	22.18	38.82	66.40	88.33	285	35.12
OKLAHOMA	27.48	47.38	70.77	91.40	354	28.22
OREGON	23.81	37.41	65.46	90.47	283	35.31
PENNSYLVANIA	29.89	47.57	71.08	89.97	378	26.45
RHODE ISLAND	38.09	55.56	76.81	96.09	553	18.08
SOUTH CAROLINA	24.81	39.77	67.59	90.76	301	33.26
SOUTH DAKOTA	26.82	38.88	62.09	88.92	309	32.37
TENNESSEE	27.17	45.29	71.41	90.45	353	28.35
TEXAS	30.13	45.62	69.77	89.69	359	27.87
UTAH	24.02	42.67	68.57	93.47	314	31.85
VERMONT	38.79	54.54	78.23	95.55	750	13.33
VIRGINIA	26.99	43.39	70.14	92.42	336	29.79
WASHINGTON	25.02	40.40	69.48	93.48	318	31.49
WEST VIRGINIA	34.74	50.71	75.47	93.61	455	21.96
WISCONSIN	26.71	42.04	67.82	90.11	327	30.61
WYOMING	34.14	54.15	79.74	97.54	494	20.22
UNITED STATES	24.01	38.48	63.26	81.95	271	36.90

06/17/86 -- NAII RESEARCH SOURCE: A.M. BEST

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM WILLIAM L. LARSEN

Question 1. Let me first address the availability problem. Some people have argued that the present insurance crisis was made by the insurance industry and have argued for repeal of the McCarran-Ferguson Act as the solution. Under present law, can insurers engage in boycotts of insureds?

Answer. Under current law, insurers cannot engage in boycotts of insureds. The McCarran-Ferguson Act does not provide a blanket exemption from anti-trust laws. A panoply of insurer activities are subject to anti-trust laws despite state regulation of insurance. In addition to state anti-trust laws, insurance companies are subject to the Robinson-Patman Anti-Discrimination Act and the Sherman Act, which prohibits boycotts, coercion and intimidation. Moreover, courts in recent years increasingly have limited the application of McCarran-Ferguson by narrowing the definition of "the business of insurance." In short, the McCarran-Ferguson exemption does not extend to boycotts of insureds and any such action by insurers would be in violation of federal anti-trust law.

Question 2. In order to evaluate the likely effect of repeal of McCarran-Ferguson, it is important to know the level of competition in the industry today. Could you give us some figures as to the number of companies and their market shares in some of the different types of insurance we are discussing today? Would those concentration levels be high or low on a traditional index of concentration, such as the Herfindahl-Hirshman index?

Answer. In general, the level of competition in the property/casualty insurance industry is quite high. In 1984, 3474 property/casualty companies were offering insurance to the public. About 900 of these companies operated in all or most states. In terms of national market share, the top ten writers of property/casualty insurance (excluding accident and health insurance) had a 1984 market share of 37.4%. Broken down by company groups, top ten property/casualty market shares were as follows in 1984:

State Farm Group	9.41%
Allstate Insurance Group	5.47
Aetna Life and Casualty Group	3.56
Cigna Group	3.36
Farmers Insurance Group	2.92
Travelers Insurance Group	2.89
Fireman's Fund Group	2.63

Hartford Insurance Group	2.50
Liberty Mutual Group	2.39
American International Group	2.27
Total of Top 10 Writers	37.40%

These market share figures indicate that the concentration level in property/casualty insurance is not particularly high. This relatively low level of concentration on a national basis is reflected in individual property/casualty lines of insurance as well. For example, in the commercial automobile line of property/casualty insurance, the top ten writers nationally hold a total of 34.13% of the market. Individually, the market shares of these commercial automobile insurers range from 4.48% to 2.39%. Similarly, for property insurance (including homeowners, commercial multi-peril and fire insurance), the market shares of the top ten writers nationally total 39.68% for 1984. While individual company market share percentages will vary by state and line of insurance, in general, the property/casualty industry's market share percentage data indicate a relatively low level of concentration.

Question 3. Of course, affordability is another problem. It has been suggested that the industry is raising prices in order to make up for poor underwriting practices over the last few years. Could you comment on that view? What assumptions are you making in setting rates with respect to the laws that you will be paying out under?

Answer. Some critics charge that insurers laid the groundwork for availabilty and affordability problems through heated competition and inadequate pricing during the late 1970's. It is true that underpricing of insurance did drop premiums well below the level needed to cover costs in some lines of insurance. This was due to intense competition for premium dollars in an era when premiums could be invested for high inflation-driven returns. These high investment returns enabled insurers to reduce the price of their product by balancing underwriting losses with investment income. The extensive price-cutting benefitted many policyholders. In 1984, however, underwriting losses overtook investment income.

The intense competition of 1979 to 1984 exacerbated increasingly severe operating losses and thus contributed to availability and affordability problems. But other factors also were at work. Chief among these factors was the expansion of tort liability by a series of court rulings involving particular legal doctrines that are treated at greater length in our testimony. Expansion of tort liability has led to an increase in the number of situations for which an insured will be held liable and to which, consequently, liability insurance must respond. Fundamental changes in the nation's system of redressing tort liability have been under way for a number of years. Unfortunately, these changes have made the liability system unstable and unpredictable.

Two fundamental concepts underlie insurability and insurance contracts: risk and predictability. If a loss is certain to happen, then there is no risk of loss to transfer, and an insurance transaction cannot take place. There is a growing perception among underwriters that the accumulation of legal remedies provided under state and federal liability systems is changing a hitherto insurable probability of loss to an uninsurable certainty of loss Underwriters are attracted to predictability of loss, but must avoid inevitability of loss. Moreover, if there is no way to forecast the timing or amount of a loss from past experience, then the loss is unpredictable. Any estimate would be pure speculation.

As explained in greater detail in our testimony, the past assumptions that insurers used to set rates, although based on longstanding interpretations of tort law, no longer seem to be valid. Instability and unpredictability in the tort liability system mean that insurers must change their assumptions in setting rates for underwriting various risks. Unfortunately, this has led recently to higher costs for the insured public and, in some cases, difficulty in finding insurance for certain categories of risk. As we note in our testimony, so long as the legal system operates to make it difficult or impossible to assess risk, the problems associated with the availability and the cost of liability insurance will continue and possibly worsen. Tort reform is essential if commercial casualty insurance is to be available at prices the public can afford.

Question 4. Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would receive an additional award equal to 25 percent of the judgment.

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DODD--LARSEN

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

Answer. The American Insurance Association understands and shares the concerns of Senator Dodd about the need to reduce transaction costs in the context of resolving product liability claims. According to a recent study by the Rand Corporation, only about 50% of all money expended in our civil justice system actually gets to victims. The remainder is spent on court costs and party litigation expenditures.

In his opening statement in support of this provision before the Commerce Committee, Senator Danforth expressed the hope that its adoption would have the beneficial effect of providing incentives for parties to settle their differences without resorting to litigation. The plaintiff would be in a better position to be compensated early while the defendant would benefit from the reduction of legal expenses.

We are not totally convinced that the adoption of this amendment would restore the predictability needed for insurance underwriters to evaluate the risks associated with a particular activity. While insurers and their insureds might be able to effectively cap their damages, they still face the uncertain environment which exists under current tort law. They remain exposed to the imposition of joint and several liability, which effectively means that they are responsible for the risks caused by another party who is outside of their control. We also have some concerns that in an effort to provide greater compensation to defendants, juries will assess damages that are actually ineligible pain and suffering awards but include them in the category of net economic loss. Even with some reduction in transaction costs under the Dodd/Danforth approach, in the end product manufacturers and sellers would continue to operate in an uncertain legal environment.

We therefore would recommend that S.1999 be amended to provide fault-based standards and affirmative defenses. This would better provide the predictability that is so important to sound underwriting practices.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM
MICHAEL D. McCAFFERTY C.S.C.

Q. Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would receive an additional award equal to 25 percent of the judgment.

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

RESPONSE OF FATHER McCAFFERTY

I am in favor of the basic approach outlined above, to the extent that it offers an injured party the opportunity to seek relief through arbitration rather than the traditional lawsuit. I believe that development of mechanisms such as this for alternative dispute resolution hold great potential for alleviating some of the problems of delay and excessive verdicts commonly associated with litigation. I also find the cap on pain and suffering in the context of the arbitration alternative an attractive concept. It strikes me that this is a reasonable trade-off to give to the manufacturer to balance the plaintiff's right to choose arbitration as the forum for resolution of the claim.

I also like the concept of encouraging a settlement offer if the plaintiff opts for a lawsuit rather than arbitration. It is obvious that to make such offers work there must be some positive and negative inducements for both parties, and the proposed amendment represents a thoughtful attempt to build in such inducements. However, with respect to that part of the amendment which addresses the downside to the plaintiff and upside to the manufacturer if the manufacturer offers to settle and the plaintiff declines, I have some problems with (i) a cap on pain and suffering equivalent to the cap operative in the arbitration and settlement context and (ii) elimination of the collateral source rule.

While I generally favor the idea of a cap on pain and suffering, whether the forum be arbitration or a lawsuit, it strikes me that use of a cap in the case of a declined settlement offer equal to the cap applicable to arbitration and settlement may place too much leverage in the hands of the manufacturer. The injured party is virtually forced to accept the settlement offer since (except for the possibility of punitive damages), he cannot recover more in the lawsuit than he could in the settlement. With respect to elimination of the collateral source rule in this same scenario, I am generally opposed to elimination of the collateral source rule for the reasons which I mentioned in my testimony on May 15, 1986.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR DODD FROM
GEORGE K. BERNSTEIN

Q. Senator Danforth and I have recently introduced a products liability bill, as an amendment to S.1999, which seeks to address, in the products liability area, the insurance availability and affordability problems we are exploring at this hearing today. The basic approach is as follows: A person injured by a product would have a choice as to where to seek recovery. Choice number one would be to file a claim against the manufacturer. In order to discharge the claim, the manufacturer would have to agree to pay net economic loss plus up to $250,000 for pain and suffering in cases of death or serious and permanent injuries. Any disagreements as to the appropriate amount would be submitted to arbitration. Choice number two, would be for a claimant to file a lawsuit. In that suit, the manufacturer could seek to settle the claim on the above terms. If the manufacturer makes such an offer, and the claimant turns it down, then the manufacturer would be the beneficiary of three changes in the tort system: a cap on pain and suffering of $250,000; abolition of the collateral source doctrine; and restriction of joint liability to net economic losses only. If the manufacturer refuses to make a settlement offer along the stipulated lines, then the claimant may proceed with the lawsuit with few changes in the tort system (with the exception of a limit on punitive damages to twice the amount of compensatory damages). If the claimant recovers, the claimant also would receive an additional award equal to 25 percent of the judgment.

Please give me your comments on this approach and whether you think a similar approach may prove workable and desirable in this area as well.

A. My personal opinion with respect to Senator Danforth's amendment to S. 1999 is that it would be essentially a meaningless addition to the law. I do not believe that the disincentives to plaintiffs' use of litigation are sufficient to significantly reduce either the amount of litigation or its attendant costs and the dollar amounts ultimately paid.

Moreover, even if there is some reduction in litigation and costs, Senator Danforth's approach, which does not include real tort reform that addresses such abuses in the current system as joint liability, absence of state of the art defenses, retroactive liability, absolute liability, absence of penalty for frivolous suits and other current liability system abuses, will have no substantial impact on the availability and price of liability insurance.

AMERICAN
BANKERS
ASSOCIATION

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Washington, D.C.
20036

EXECUTIVE DIRECTOR
GOVERNMENT RELATIONS

Edward L. Yingling
202/467-4097

June 24, 1986

The Honorable Chic Hecht, Chairman
Subcommittee on Housing & Urban Affairs
United States Senate
534 Dirksen
Washington, DC 20510

Dear Chairman Hecht:

The American Bankers Association is pleased to submit the attached statement regarding the liability insurance crisis. We request that this statement be made a supplementary part of the transcript of your Subcommittee's recent hearing on this subject.

The statement makes the following points:

o The ABA is establishing a captive insurer to provide adequate and affordable directors and officers liability, and bankers blanket bond insurance, to ABA members on a stable, long term basis.

o Some tort reforms may be desirable, including a return to fault-based liability and limitations on joint and several liability. Banks are concerned about the impact of liability judgments against their customers, as well as about a growing number of lawsuits brought against banks based on new theories of "lender liability".

o Other causes of the liability crisis include a capacity shortage and imprudent cash flow underwriting. The crisis is symptomatic of an industry which is inefficient, anticompetitive, and subject to cyclical crises.

o Anticompetitive aspects of insurance include state laws, such as "anti-rebate statutes", which forbid price competition, and the industry's broad exemptions from antitrust coverage.

o Banks are extremely interested in adding additional capacity through underwriting many insurance lines. Banking and insurance are strikingly similar in financial functions; most insurance activities are less risky than commercial lending.

o Consumers support bank entry into insurance and would benefit from added convenience and competition, with potential cost savings in the billions. While possible coercive tie-ins are exaggerated, they can be avoided by protections which apply to all financial providers combining credit and insurance sales--including insurers, who are already engaging in such cross-selling.

We hope that our statement is helpful to the Subcommittee as it continues its further exploration of this complex issue. We stand ready to provide whatever additional assistance requested.

Sincerely,

Edward L. Yingling

Edward L. Yingling

Enclosure

cc: All members of the Subcommittee

STATEMENT OF

THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the Subcommittee, The American Bankers Association is pleased to submit its views regarding the ongoing crisis in the affordability and availability of liability insurance. The combined assets of ABA member banks comprise approximately 95 percent of the idustry total. Our members range in size from the smallest to the largest banks, and close to 85 percent of them have assets of less than $100 million.

ABA MOVES TOWARD ESTABLISHING INDUSTRY CAPTIVE

During 1985 the Executive Committee of ABA's Security and Risk Management Division recognized that the banking industry was facing a crisis in the form of a restrictive and highly expensive insurance marketplace. We saw that the directors and officers of many banks would be forced to go unprotected by insurance, and that this would create a level of risk which many would not be willing to assume. As a result, many banks, particularly smaller banks with troubled loan portfolios, faced increasing difficulty in attracting and retaining high quality directors and officers. Member banks reported with growing frequency that they either could not find directors and officers liability insurance or bankers blanket bond coverage, or that they were being forced to pay exorbitant premiums - often as much as a thousand percent increase in a single year - to obtain coverage which had been reduced in scope. Overall, we found that increases for renewal premiums for bankers blanket bond policies averaged three hundred to four hundred percent, and that deductibles averaged five hundred percent.

We believe that the bankers blanket bond problem can be attributed to several factors: 1) a severe price war among insurers; 2) lax underwriting standards; 3) a decline in interest rates which caused insurers' investment income to decline; and, 4) high losses, often due to fraud.

The directors and officers liability problem appears to result from: 1) extreme underpricing; 2) a higher number of bank failures, primarily due to problem agricultural and energy loans; 3) FDIC suits against the directors of failed banks; and, 4) a growing number of private suits against bank officers and directors.

In response to this developing crisis, last July the ABA undertook a study to determine the feasibility of establishing a program which could lessen banks' dependence on the cyclical insurance marketplace, and provide ABA member banks with access to a stable insurance market source offering reasonably priced insurance coverage. That feasibility study was completed in December. It determined that any negative ramifications of rejecting the application of an ABA member bank could be minimized by clearly stating underwriting accaptance criteria in advance, and by utilizing a fronting company to perform the underwriting function and provide a disinterested third party. We also concluded that any ill will resulting from such rejections was more than outweighed by the need for ABA to assist its members in surmounting the insurance crisis. Our study also determined that at least $20 million in start-up capital would be necessary to establish a captive and purchase necessary reinsurance. Estimated capital contributions required from participating banks will average about $15,000.

Proper structuring of the captive will minimize any risk to the ABA, and legal problems will be avoided by forming the captive as a mutual company.

The feasibility task force recommended that ABA should assume a leadership role in addressing banking's insurance crisis. It determined that only a captive insurance company operating nationwide could generate sufficient capital to attract necessary reinsurance, and thereby provide a lasting, stable insurance marketplace for America's commerical banks. The captive would be owned by its policyholders and operate, in an arrangement using a licensed commercial insurer to write and issue policies to participating banks. The captive would subsequently enter into a contract with the commercial insurer to reinsure the premiums and losses of each participating policy. This arrangement is known as "fronting" and the licensed primary insurer as the "fronting company". The captive would be a mutual company so as to permit capitalization contributions by member banks and to most easily satisfy regulatory requirements.

After considering the task force's conclusions, ABA's Board of Directors approved moving toward establishing a captive insurance company. On February 21 of this year the President of the ABA wrote all ABA member banks to ascertain that there was sufficient interest in the banking community to justify the establishment of an ABA captive. Their response indicated overwhelming support for a national banking industry mutual insurance company to provide directors and officers liability and bankers blanket bond insurance coverage. On a nationwide basis the survey found that a significant majority of questioned banks were interested in obtaining liability coverage from an ABA captive, and would be willing to contribute an average of $15,000 to capitalize this entity.

Presently, the ABA is engaged in continued negotiations with both domestic and foreign reinsurance companies, whose participation can reduce the overall risk of this venture. We are extremely optimistic that the ABA, by virtue of its national scope and its long-standing relationships with the key reinsurance providers, will be successful in assisting the industry to create an additional source for both directors and officers liability and bankers blanket bond coverages. We are extremely hopeful that, barring unforeseen difficulties, the captive can be established and begin accepting business no later than this fall.

In sum, the banking industry has been directly affected by the liability insurance crisis. The ABA is moving expeditiously toward the establishment of an industry owned captive which can prevent banks from being denied adequate protection for themselves, their officers and directors. ABA's decision to use a fronting company obviates the need, in our case, for proposed legislative relief to ease the way for industry formed captives licensed in a single state to extend protection to industry members on a nationwide basis. Small groups of bank holding companies are also moving to establish captive insurance providers, aided by recent Federal Reserve rulings which permit bank holding companies to band together for this purpose. The captive liability insurance program being developed by ABA will be of use to banks of up to $2 billion in assets; the limits on protection, while meeting the needs of the vast majority of banks, would not be sufficient for the nation's largest banking organizations. The nation's largest banking institutions are, in many instances, joining with other Fortune 500 corporations to establish captives that can provide adequate liability coverage.

Beyond the accelerating movement by bankers to establish captive liability insurance providers, the banking industry is also reviewing proposals for broader reforms which can promise significant long-term relief. The ABA is reviewing proposals for tort reform emanating from the Administration and other policymakers. In general, ABA favors a return to fault-based liability and limitations on joint and several liability.

We are of course familiar with anecdotes describing lawsuits of questionable validity resulting in multi-million dollar rewards against parties with little contributing negligence. In a growing number of cases, banks find themselves faced with large potential damages when they are included as co-defendants in liability cases--generally not due to any direct responsibility, but probably because they are seen to have "deep pockets". New theories of "lender liability" and even "banker malpractice" are emerging as courts and juries second-guess bank decisions to enforce contractually agreed-upon provisions of loan and credit documents. In several recent cases, banks have been required to pay compensatory and punitive damages far in excess of the credit or debt invloved. Long-standing common law theories are being dramatically expanded in judicial determinations that the express provisions of contracts should be supplemented by sundry implicit duties and caveats. To a considerable extent, bank management can attempt to insulate itself from this accelerating trend by a careful examination and revision of legal forms and management practices. However, statutory change may also be required; at a minimum, a bank should not be liable to paying damages far in excess of the credit at issue when it has adhered to the letter of loan documents. A failure to redress these developments will inevitably result in an increase in the cost of credit and a narrowing of its availability, as banks seek to avoid any lending situation that might give rise to debtor-initiated litigation having the potential to bring a lender to its knees.

While tort reform may be part of the comprehensive solution required for the liability crisis, it also seems clear that some major insurers departed from sound actuarial standards during a period when they became investors first and insurers second. Unfortunately for policyholders, their underpricing, focused on gaining investment funds, did not consider the impact on business and government when interest rates, inevitably, declined.

BANK UNDERWRITING WOULD ADD TO CAPACITY

While your Subcommittee is immediately concerned with discerning whether there are positive steps which Congress could take to alleviate the immediate liability crisis, we also believe you should recognize that this crisis is but the most visible symptom of an insurance system whose economic inefficiencies result in billions of dollars in excessive costs to consumers and businesses and to repeated cyclical crises in the availability and supply of insurance. The ABA believes that permitting banking organizations to enter into the insurance industry would add substantial new underwriting capacity, would result in billions in annual savings for consumers, and would produce competitive benefits that would provide long-term gains in industry efficiency. Many commentators on the insurance industry have observed and remarked upon its glaring inefficiencies. In his 1982 study of the insurance industry, The Invisible Bankers, Andrew Tobias specifically compared the efficiencies between insurance and banking:

> The analogy to banking is an important one. In both cases, the product is really only money. Banks - and insurance companies - are "financial intermediaries." They collect deposits from people and businesses with extra cash and lend it to people and businesses (and governments) that need to borrow some. The difference, as I say, is that with a bank you are entitled to withdraw 100 percent of what you deposit, often with interest. With an insurance company, you and your fellow insured as a group will wind up withdrawing much of what you put in, but just how much any individual can draw out depends on his luck. The worse his luck, the more he is allowed to withdraw...
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> But there is a second difference as well. Where a bank is able to safeguard your money, process all your checks, insure your account with FDIC, pay for all those radio jingles, pay the rent on its building, and so on, at little or no charge to you - insurance companies are unable to do this. For every dollar we collectively "deposit" with an auto insurer, for example, only 65 cents or so is available for our collective withdrawal. (Some will withdraw much more, many will withdraw nothing, but on average, for every dollar Americans pay in auto insurance premiums, 65 or 70 cents gets paid back out.) Some bank! Deposit a dollar, withdraw 65 cents. The rest of our dollar, plus the interest the insurance company earns on it, goes to expenses, overhead and profit.
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> What kind of bank gives back just 65 percent - often less - of what you deposit? Indeed, when you compare the services of a bank and an insurance company, common sense suggests something is out of whack. Think how often you deal with your bank, how many checks it clears for you in the course of a year, how many statements it mails you, loan it discusses with you...and then think how much contact you are likely to have with your insurers. Why can one live off the interest on the balance in your checking account, while the other needs to take 35 cents - or more - of each dollar you deposit? Could it be that one is vastly more efficient?
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> It takes 1.9 million people to staff the insurance industry. Would you say it takes twice as many to run the banks? Five times as many? (After all, they have all those credit applications to analyze, all those security guards to keep on patrol, all those toaster-ovens to give away.) At the end of 1980 there were actually more Americans employed in the insurance industry than in banking. The banks presided over three times as much money, handled vastly more "transactions" - and yet managed to make do with about a quarter of a million fewer people. And

without grabbing off 20 or 40 or 50 cents of each deposited dollar.

The gains in efficiency that would result from new competitive forces in insurance would be complemented by the additional capacity brought in by banking participants. A just-published American Banker survey of the nation's major banking organizations found that 79% were interested in underwriting group life insurance, 67% in individual life insurance, and 38% in property/casualty coverage for individuals or businesses. Banks observing the present disaster in some areas of the commercial property/casualty field would not rush in to fill this void were they granted underwriting powers today. Bank entry into underwriting would start slowly and focus on more actuarially predictable and less risky sectors, while leaving the most exotic insurance products to the experts. Nonetheless, the overall increase in insurance capacity would promote long-term stability and would free up overall capacity to permit coverage of abandoned sectors; and gains in efficiency resulting from new competitors would provide long-term savings to insurance purchasers and promise a way out from the cyclical disruptions that have characterized the insurance business.

The need for additional capacity in the insurance underwriting field was amply documented more than a year ago by the property/casualty industry's own non-profit statistical organization. The Insurance Service Office's February 1985 study on "The Coming Capacity Shortage" predicted that the availability of property/casualty insurance would fall short of demand by $62 billion in the 1985-88 time frame. In this study's evaluation and recommendations section, it strongly questions the continuation of the insurance industry's strident opposition to entry by other financial entities, stating:

> "New Players? Given a capacity shortage - and society's need for risk protection - one must ask: Is it realistic to assume that our society will continue to countenance barriers to entry into the insurance business by other financial institutions? Those in the business who want to prevent new entities - with their available capital - from invading their turf may discover that these players are deperately needed in the next few years. New circumstances may call for a reevaluation of positions that were initially forged when excess capacity was the order of the day."

The ABA believes it is incumbent upon your Subcommittee to engage in the same process of reevaluation of prohibitions which have resulted in unnecessary reductions in capacity and competitive vigor.

BANKING AND INSURANCE ARE VERY SIMILAR

While some may try to convince you that banking and insurance are such radically different industries that an executive in one can never understand the workings of the other, the reality is that insurance and banking are simply different methods of managing financial risk which complement one another in the financial plans of individuals and businesses. The similarities between the industries are striking.

Banks are leveraged institutions that fund themselves by soliciting deposits that they invest by making loans and purchasing securities. Banks assume and manage a wide variety of risks (such as credit, concentration, liquidity, and interest rate risks) in order to be able to pay their depositors at the time and in the manner that they promised, and still have left over sufficient income from their investments to provide a fair return to their shareholders.

Insurance companies are leveraged institutions that fund themselves by soliciting premiums which they invest by making loans and purchasing securities. Insurance companies assume and manage a wide variety of risks (such a actuarial, concentration, liquidity, and interest rate risks) in order to be able to pay their policyholders, the insured, at the time and in the manner they promised and still have left over sufficient income from their investments to provide a fair return to their shareholders or other owners.

From a producer's point of view both banking an insurance involve four functions -- origination, investment, processing and liability management. The only substantive difference between banking and insurance is in the degree of probability or predictability of the events that bring about a requirement to pay out on the liability side. And even here the differences are not that dramatic.

Origination means understanding the customer's financial problem, developing a solution, and issuing the appropriate instruments to solve it. Banks have developed an understanding of these problems and how they can be solved. What they need is the authority to implement a full range of solutions.

Investment concerns the management of the firm's assets. Banks have extensive experience in managing the assets in which insurance companies invest. Thus, banks could manage an insurance company portfolio without difficulty.

Processing means just what it says -- managing the flow of paper and electronic data necessary to complete a transaction. Banks operate the payment system for the world's largest economy and could easily perform the collection and disbursement activities that insurance companies engage in.

Liability management does differ between banks and insurance companies. Banks must manage their assets and liabilities in order to meet their depositors' demands. Such demands are predictable only to a limited extent. Insurance companies must manage their assets and liabilities in order to meet policyholders' claims. But many of these claims are substantially predictable, as evidenced by the reliability of mortality statistics used to set life insurance rates and coverage. Property and casualty events are, of course, less predictable, but here too, volumes of statistics on property and casualty risks make predictability more than a betting game.

Turning to specific product areas, life insurance exhibits strong similarities to banking. For example, the traditional whole-life policy contains a tax-deferred savings account and a pre-approved line of credit that allows the policyholder to borrow against the cash value of the policy. Variable or universal life insurance allows the insured to invest his savings a tax-deferred mutual fund, similar to that offered by banks in IRA or Keogh accounts. Thus, life insurance is primarily a savings vehicle. Banks already have extensive experience in the distribution of credit life insurance.

As for property/casualty insurance, it too has strong similarities to banking. On the asset side, insurers assume the same type of investment risk incurred by banks as managers of their own portfolios or as managers of trust assets beneficially owned by others, such as pension funds. On the liability side, banks must continuously appraise, in connection with their extension of credit, the value of property such as autos and homes.

In addition to these many similarities between the functioning of the banking and insurance industries, marketplace evolution is erasing the distinctions between many banking and insurance products. For example, the ABA does not perceive any functional difference between a bank's standby letter of credit or an insurance company's financial guarantee, both of which are issued in conjunction with securities offerings and both of which compete head to head for that business. The functional equivalency of many bank/insurance products was noted by the Federal Reserve Board in its March 20 approval of Citicorp's application to underwrite and reinsure home mortgage redemption insurance. The Board noted that its decision departed from precedents because "market developments have narrowed substantially the differences between credit life insurance and home mortgage redemption insurance". In reaching its decision the Board determined that there would be considerable net public benefits from Citicorp's entry, including the availability of insurance products with a greater variety of features. The approval was also accompanied by voluntary safeguards against any appearance of tying between this new product and any credit extensions or other services offered by Citicorp or its subsidiaries.

CONSUMERS WOULD BENEFIT FROM BANK ENTRY

In seeking to expand into the insurance business, banks are constantly confronted by representatives of the insurance industry who assault our aspiration with two major arguments. The first is what we call the "too weak and too strong" argument. This is where the insurance industry claims that banks are so weak that entering the insurance industry would bring them down, and that banks are so strong that if they were permitted to enter the insurance industry they would drive everyone else out of it. Obviously, there is somewhat of an inconsistency in that argument. It is an argument which ignores the fact that, except for underwriting certain lines of business property and casualty insurance, most other aspects of the insurance business caryy little risk. It ignores the fact that the banking industry is fundamentally sound, as was testified to before the Banking Committee this Spring by all three federal banking agencies. While there are indeed a record number of bank failures due to problems in the energy and agricultural lending area, as well as to the lingering effects of the 1980's transition from hyper-inflation to recession to disinflation, the capital base of banking industry continues to expand. Likewise, the FDIC fund has grown larger in each of the last several years, and even the most publicized bank failures have been handled without disruption to the financial system, and without cost to the taxpayer but with bank contributions to the FDIC. While there are indeed problems within the banking system, banks have not so mismanaged their affairs as to plunge the entire nation into a crisis akin to the liability insurance crisis.

As for the contention that banks will rapidly take over the insurance industry, we find this rather far-fetched. Bankers have a hard enough time cross-selling a savings account and a checking account to the same customer, much less effectively packaging together a far broader array of financial products and services. Despite these marketing difficulties, there is no reason why commercial banking should remain the last and only sector of the financial services industry whihc is denied the opportunity to both extend credit and sell and underwrite insurance. Frankly, from a public policy standpoint, we can see no reason why Congress should continue to permit an industry whose stewardship of the payments system is vital to become noncompetitive due to continued denial of needed product and service freedoms.

I would note that banking is probably the most extensively regulated industry from the Federal perspective, while essential insurance activities and practices are not subject to Federal regulation; that any bank holding company engaging in tying activities is subject to treble damages under the Bank Holding Company Act, whereas insurance companies are subject to no such penalties; and that banks are subject to antitrust restrictions more severe than general antitrust law, while the core activities of the insurance industry remains exempt from substantial portions of the antitrust statutes. The anticompetitive implications of this continued exemption were pointed out in the 1979 report of the National Commission for the Review of Antitrust Laws and Procedures which stated, "As presently interpreted the McCarran-Ferguson Act effectively may immunize from the antitrust laws a broad range of anticompetitive activities which in fact serve no federal or state objectives...there is simply no justification for retention of the immunity in its present form."

Occasionally even the insurance industry admits that their predictions of rapid bank takeover are without justification. For example, a 1983 study commissioned by the American Insurance Association, Expansion Of Banks Into Insurance, found that "there is little opportunity to buy significant market share in the property and casualty industry. Conversely, deposit taking institutions generally do not dominate their markets to such an extent that substantial market power could be used to force their way into the markets by compelling the purchase of an insurance product by their depositors." The fact that suits have rarely been brought under the anti-tying restrictions of the Bank Holding Company Act, as well as the fact that the reported abuses have been minor in the sixteen states where over 1400 state chartered commercial banks are today providing general insurance agency services, indicate that the tying argument simply does not hold water.

Of course, coercive practices can occur in individual situations. For example, a Wall Street Journal article of September 10, 1985 reported that some insurance agencies were forcing parents to buy life insurance policies in order to obtain Federally Guaranteed Student Loans for their children. According to the Journal story these same parents later found that "they easily could have gotten the same loan at a bank without any strings". By no means does ABA wish to imply that the vast majority of insurance agents engage in such coercive sales practices. However, we wish that representatives of the insurance agents would cease asserting that most bankers are incompetent and dishonet.

If there is needed implicit coercion in every situation in which the same financial organization both sells insurance and extends credit, then perhaps consumer protections are needed. Of course, the insurance industry would be the primary target of such safeguards for it has extensively integrated itself with the banking industry. Insurance companies own dozens of nonbank banks, all of which are likely to be grandfathered if Congress addresses this issues. They also engage in many other credit extension activities.

For example, the Metropolitan Life Insurance Company, the nation's second largest life insurer, recently purchased the largest real estate brokerage network in the United States, Century 21. In 1984 Century 21 had eleven percent of the total U.S. homes sales market. While we do not intend to imply that Century 21 engages in any tying arrangements, we do note that this acquisition was made to facilitate the cross-selling of real estate brokerage, mortgage finance and homeowners insurance products. Certainly, if a consumer is ever to feel implicit pressure to purchase insurance products as a condition of receiving credit, it would seem to arise in the mortgage finance transaction - the largest loan that most Americans ever secure. Eventually, Metropolitan plans to put an insurance underwriter in each of the 2000 largest Century 21 offices and to train Century 21 real estate brokers to sell all Metropolitan insurance products. Similar attempts to cross-sell loans, insurance, and other financial products and services are being undertaken by Sears, Prudential-Bache, American Express, and even Ford and General Motors. Ford owns the eighth-largest interstate S&L in the country; S&L service corporations can engage in all insurance activities.

The banking industry's position on these developments is very simple: We need the same competitive freedom. And if there is a need for consumer protections, let them apply across the board.

However, we believe that the claims of coercive tie-ins are vastly exagerated. For example, a February 24 report to the Consumer Advisory Council of the Federal Reserve Board reviewed the consumer experience with credit insurance obtained on nonmortgage closed end debt. The results revealed that nearly all borrowers who purchased credit insurance thought that it was good idea and would do so again in the future. Moreover, the vast majority of borrowers, in excess of 95 percent, felt that their decision to buy insurance had no effect on the creditor's decision to grant the loan regardless of whether or not they had purchased the insurance.

In point of fact consumers would not suffer were banks permitted to sell insurance - they would benefit greatly from increased convenience and competition. A December 1985 survey of consumers conducted by the Maxwell School of Citizenship and Public Affairs of Syracuse University found that New York State residents felt that all banks should be permitted to sell all types of consumer insurance. Residents of that state were very satisfied with the insurance they were already purchasing from banks, such as low-cost savings bank life insurance, and were dissatisfied with the current system of selling insurance. Based upon similar input, New York State's Temporary Commission on Banking, Insurance and Financial Services recommended in 1984 that "the remaining legal and regulatory barriers to entry between banking and insurance firms are no longer required to serve important public policy objectives...the Commission believes that gradual removal of these barriers will lead to increased competition and corresponding benefits to consumers."

The New York State Commission recognized that consumers are way ahead of the regulatory framework. They view insurance as one of many financial product choices, and they instinctively know that they benefit from increased competition and greater convenience. Similarly, banks view many insurance products as commodity-like in nature; that is, products which are characterized as fairly standard and uncomplicated, widely available through alternative delivery systems from large numbers of suppliers, where price and service quality are the key differenciating factors. Banks have developed extensive branching systems which are difficult to support in an era of interest rate deregulation, but could become cost-effective and convenient distribution points for a wide variety of financial products and services if the laws would just catch up to the marketplace.

We believe that bank entry into insurance delivery could save American consumers about 10 percent of their insurance premium costs on an annual basis by reducing distribution costs from $.25 of every premium dollar to $.15. Cutting distribution costs is the method by which direct insurance writers are gaining expanded market share every year from companies using the agency system. Banks, by using their existing distribution system and their marketing know-how, would hope to save consumers $8 to $10 billion per year in insurance costs. The figure may seem high until you consider that U.S. consumers pay out $120 billion per year in insurance premuims, and that $10 to $15 billion of this is commissions to agents.

Those potential cost savings gain pausibility when you consider the extremely anticompetitive nature of the present insurance system. In addition to the industry's blanket antitrust immunity, most states have so-called anti-rebate laws which prevent any price competition in insurance distribution. Recently, the Dade County Consumer Advocate's Office was successful in overturning Florida's anti-rebate law. On June 6, the Florida Supreme Court affirmed the lower court determination, stating that "these statutes unnecessarily limit the bargaining power of the consuming pulic...we find no identifiable relationship between the anti-rebate statutes and a legitimate state purpose in safeguarding the public health, safety or general welfare. The other arguments presented by the Department of Insurance...have been previously unsuccessfully made to uphold statutes or regulations limiting consumers' bargaining power for other services." We believe that bank entry into insurance sales would precipitate a wholesale review of such anti-consumer provisions, and could help to establish a vastly more efficient insurance distribution system to the benefit of American consumers and the overall economy. The Florida decision has potential impact of nationwide scope, both because the Florida Court cited many U.S. Supreme Court decisions in reaching its own conclusion, and because the Florida statute is virtually identical to anticompetitive laws found in every other state. As anti-rebate laws are overturned we expect independent agents to see an acceleration of the loss of market share they have already experienced throughout the 1980's, and to come to the realization that entering into joint ventures with banks is a key route to continued viability. Vigorous price competition in the retail sale of insurance products will also enhance the ability of the banking system, with its in-place distribution system, to provide significant cost savings to consumers of insurance products.

While some in the insurance industry may complain about a broadening of bank insurance authority, progressive insurers are recognizing that intransigence will result in obsolescence, not survival. Many insurance agents are already engaged in limited joint ventures with banks, and would like banks to be able to expand their financial and professional commitment. Also, such leading insurance executives as James Morton, President and CEO of John Hancock, have stated that deregulation benefits insurers and consumers, is inevitable, and requires a comprehensive Federal approach. We second the views of such progressive insurers.

The ABA appreciates this opportunity to submit our views to the Subcommittee. Banks have been severely impacted by the liability insurance crisis, and are moving on an individual and collective basis to establish captive insurance companies as an answer to this situation. In addition, many banks have a strong interest in becoming involved in the underwriting of various line of insurance, and we believe that permitting bank entry could produce substantial competitive benefits and product innovations. Additionally, banks require broader product and service abilities in order to remain fully competitive in the evolving financial marketplace and to assure the profitability which is the ultimate source of banks' safety and soundness. The present insurance distribution system is characterized by glaring inefficiencies and anti-competitive practices, many of which could be remedied through the enhanced competition resulting from bank participation.

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